



Minnesota's School Trust Lands

FY16-17 Biennial Report
July 2018

About This Report

Department of Natural Resources

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Executive Summary

The Department of Natural Resources (DNR) manages 2.5 million acres of school trust lands and an additional 1 million acres of severed school trust mineral interests. Title to the school trust lands is vested in the State of Minnesota, in trust for the support of public schools in the state.

As outlined in Article XI, section 8 of the Minnesota Constitution, the DNR has a fiduciary duty to manage the school trust lands with undivided loyalty to the beneficiaries of the trust, Minnesota public schools.

Pursuant to Minnesota Statutes, section 127A.31, the statutory goal of the Permanent School Fund (PSF) is to secure the maximum long-term economic return from the school trust lands consistent with the fiduciary responsibilities imposed by the trust relationship established in the Minnesota Constitution, with sound natural resource conservation and management principles, and with other specific policy provided in state law.

The DNR generates revenue on school trust lands from school trust assets (i.e., resources) through mineral lease sale earnings, mineral lease royalties, forest product sales, surface use lease payments, land sales, utility crossing rights-of-way fees, interest, damage costs and other contract receipts. The rents and royalties from mineral leases are the primary revenue source from school trust assets. It is estimated that roughly 80 percent of historic revenues have come from mineral leasing activities. The DNR then transfers revenues and other income, less expenses allowed under state law, from these management activities into the PSF.



***MANAGEMENT ACTIVITIES PROVIDED \$40.69 MILLION IN INCOME DISTRIBUTIONS
TO THE PERMANENT SCHOOL FUND DURING THE FY16-17 BIENNIUM.***

In FY16 (7/1/15 – 6/30/16), the total distribution to the PSF was \$25.56 million from management activities involving minerals, forest products, surface uses and land sales. Mineral leasing and royalty payments accounted for \$21.13 million of the distribution to the PSF. Forest products and surface leasing contributed \$4.13 million and real estate activities supplied an additional \$302,370 in distributions.

In FY17 (7/1/16 – 6/30/17), the total distribution to the PSF was \$15.13 million from management activities involving minerals, forest products, surface uses and land sales. Mineral leasing and royalty payments accounted for \$11.59 million of distributions to the PSF. Forest products and surface leasing contributed \$3.19 million and real estate activities supplied an additional \$357,356 in distributions.

The economic downturn in Minnesota's iron ore industry was brought on by a significant increase in steel imports and a reduction of iron ore pellet prices during the reporting period. It is the main cause of the reduced mineral revenues year over year.

Financial Summary

	Fiscal Year 2016		Fiscal Year 2017	
Mineral Leasing Activity				
Lease Revenues & ITC Interest (100%) Directly Deposited to PSF	\$	122,682	\$	480,101
Lease Revenues (80%) Directly Deposited to PSF	\$	13,044,770	\$	9,487,257
Mineral Value Encumbrance Damages	\$	4,486,549	\$	7,382
Lease Revenue Deposited in PSF	\$	17,654,001	\$	9,974,740
	Fiscal Year 2016 Transfer for Fiscal Year 2015 Activity		Fiscal Year 2017 Transfer for Fiscal Year 2016 Activity	Fiscal Year 2017 Transfer for Fiscal Year 2017 Quarterly Activity**
Minerals Management Account Transfer to PSF*				
Minerals Management Account Revenues	\$	8,304,890	\$	4,443,397
Prior Year Adjustments	\$	1,023	\$	960
Less Mineral Management Costs	\$	(3,038,867)	\$	(2,719,875)
FY16 Amount over \$3M distributed to PSF (65.97%), University Trust (24.79%), and Tax Forfeit (9.25%) <i>percentages are rounded</i>	\$	5,267,046		
FY17 Amount over \$3M distributed to PSF (73.5%), University Trust (18.6%), and Tax Forfeit (7.9%) <i>percentages are rounded</i>			\$	1,724,482
Distributed to PSF	\$	3,474,521	\$	1,267,060
Mineral Management Total	\$	21,128,522	\$	11,241,800
			\$	347,444
	Fiscal Year 2016		Fiscal Year 2017	
Real Estate Activity				
Land Sales	\$	160,530	\$	223,102
Water Crossing Licenses	\$	141,840	\$	134,254
Real Estate Management Total	\$	302,370	\$	357,356
	Fiscal Year 2016 Transfer for Fiscal Year 2015 Activity		Fiscal Year 2017 Transfer for Fiscal Year 2016 Activity	
Timber and Surface Activity				
Timber Sales Qualifying Revenues	\$	11,151,143	\$	10,761,572
Surface Uses Qualifying Revenues	\$	1,138,221	\$	1,033,362
Non Qualifying Revenues from Surface Contracts	\$	205,213	\$	317,026
Subtotal	\$	12,494,577	\$	12,111,960
Less Forestry Certified Costs	\$	(8,159,289)	\$	(8,236,311)
Less Dept of Admin Trust Director Appropriation Land Sales	\$	-	\$	(300,000)
Less Reimbursement to Dept of Admin for Director Costs	\$	(243)	\$	(178,499)
Less Reimbursement to Perm School Fund Commission Costs	\$	(3,702)	\$	(10,348)
Less DNR Appropriation Lands and Minerals	\$	(200,000)	\$	(200,000)
Less Dept of Admin Trust Director Appropriation Real Estate Projects	\$	-	\$	-
Subtotal	\$	(8,363,234)	\$	(8,925,158)
Forest Management Total	\$	4,131,343	\$	3,186,802
Subtotal	\$	25,562,235	\$	14,785,958
			\$	347,444
Total to Permanent School Fund	FY16 \$	25,562,235	FY17 \$	15,133,402

*This section represents Minerals Management Account detail, which is needed to show the distribution over \$3M to the PSF.

*MS 93.2236 was amended in Laws of 2016 c 189 art 3 s 32 to make quarterly transfers. This table is reflecting a one time transition year, where transfers were made in FY16 and FY17 on the previous years activity, and then quarterly transfers in FY17 based on FY17 activity.

**\$472,876 is not the sum of the numbers above because dollars were transferred in error. In calculating the amount over \$3M, it did not account for the total obligation of expenses in the first and second quarters. The method of calculation has since been corrected.

Figure 1. School Trust Financial Summary

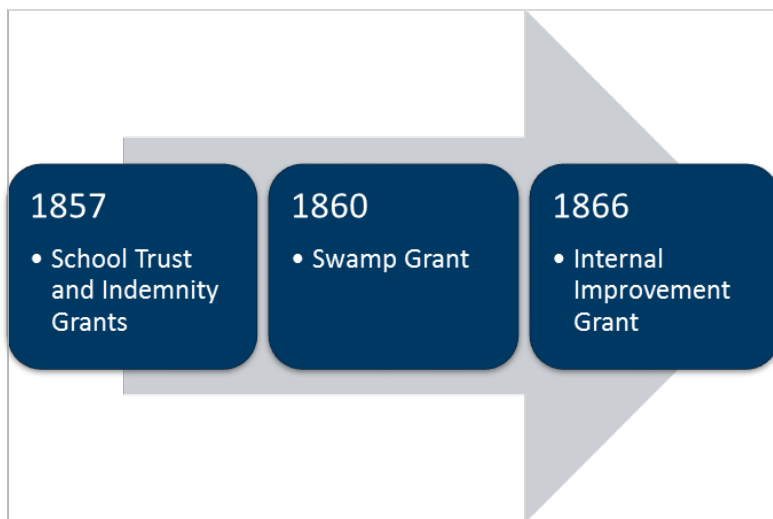
Minnesota's School Trust Lands History

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.¹ 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, 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.

A State Land Office was established in 1863 to manage the trust lands which it did until 1931. In 1931, the State Land Office was replaced by the Department of Conservation as manager of trust lands. The Department of Conservation 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.⁶



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.

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

Over time, the trustees and others began to question whether this quick sale policy was in the best interests of the trust. Other options, including leasing the land for specific purposes, were considered. In the early 1900's, the Minnesota Legislature modified its school trust management policy to place a number of restrictions on how the remaining school trust lands would be managed. These limitations shifted Minnesota's policy from one of divesting school trust lands to one of retaining school trust lands for future economic potential in addition to reserving some land for public use and enjoyment.⁷ A non-exhaustive list of legislatively imposed limitations include the 1901 law requiring a reservation of mineral rights, the 1923 law restricting sale of land bordering public waters, and a 1935 law removing commercial peat deposits from sale. From the turn of the 20th century the school trust lands were managed with the idea of "selective retention" of lands that could best be managed by the state.⁸

Federal Grant	Original Grant Acres	Grant Acres Today⁹
School and Indemnity School	2,900,000	966,749
Swamp	4,706,503	1,540,380
Internal Improvement	500,000	6,510
Total	8,106,503	2,513,639

Figure 2. School Trust Land by Grant Type

The four federal land grants described above entrusted Minnesota with a total of 8.1 million acres. All four federal grants are now considered school trust lands after constitutional amendments in 1914, 1938, 1974 and 1984. Over two million acres, roughly 92 percent, of Minnesota's school trust lands are located in ten northern Minnesota counties – Aitkin, Beltrami, Cass, Cook, Hubbard, Itasca, Koochiching, Lake, Roseau and St. Louis.

The DNR has continuously managed the school trust lands since 1931. The DNR actively manages school trust land and resources for revenue generation through the following general activities: mineral evaluation, leasing and extraction, forest products sales, sale of real property, real property easements, leasing and licenses, evaluation and leasing of surface soil resources, and leasing for recreational uses.

⁷ Minnesota Office of the Legislative Auditor, Evaluation of State Land Acquisition and Disposal, St. Paul, 1983. p. 12.

⁸ Ibid., p. 14-15.

⁹ Department of Natural Resources, Land Records System, acres reported as of December 28, 2017.

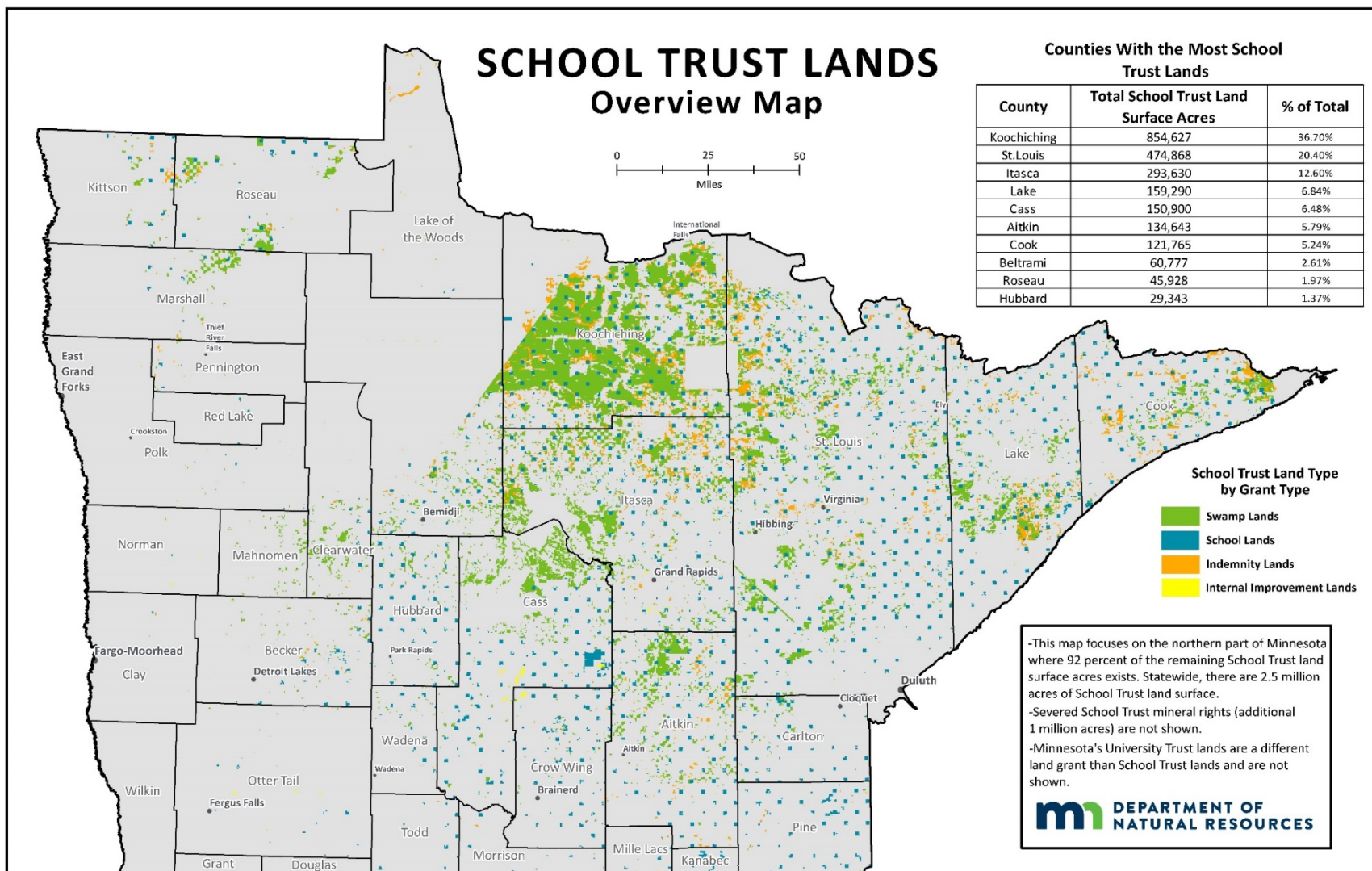


Figure 3. School Trust Lands Overview Map

The Permanent School Fund

With the acceptance of the land grant by the State of Minnesota, the Constitution created the Permanent School Fund (PSF) under Article XI, section 8. As previously stated, revenue for the PSF is generated from many activities on school trust land, including sale of timber, gravel mining leases, state forest campground fees, lakeshore leases, easements and utility licenses, the sale of school trust land, and several other types of surface use. In addition, revenue is generated from rents and royalties from mineral assets removed from trust land, leases to remove peat, non-ferrous metallic mineral leases, and several other types of mineral use.

The statutory goal of the permanent school fund, under Minnesota Statutes, section 127A.31, is to secure the maximum long-term economic return from the school trust lands consistent with the fiduciary responsibilities imposed by the trust relationship established in the Minnesota Constitution, with sound natural resource conservation and management principles, and with other specific policy provided in state law.

In June 2016, the market value of the PSF was approximately \$1.2 billion. By the end of FY17, the fund had grown to over \$1.3 billion. About \$28 million of spendable income was generated by the PSF in FY16 and distributed to the public schools. In FY17, fund payments to schools totaled about \$30 million.

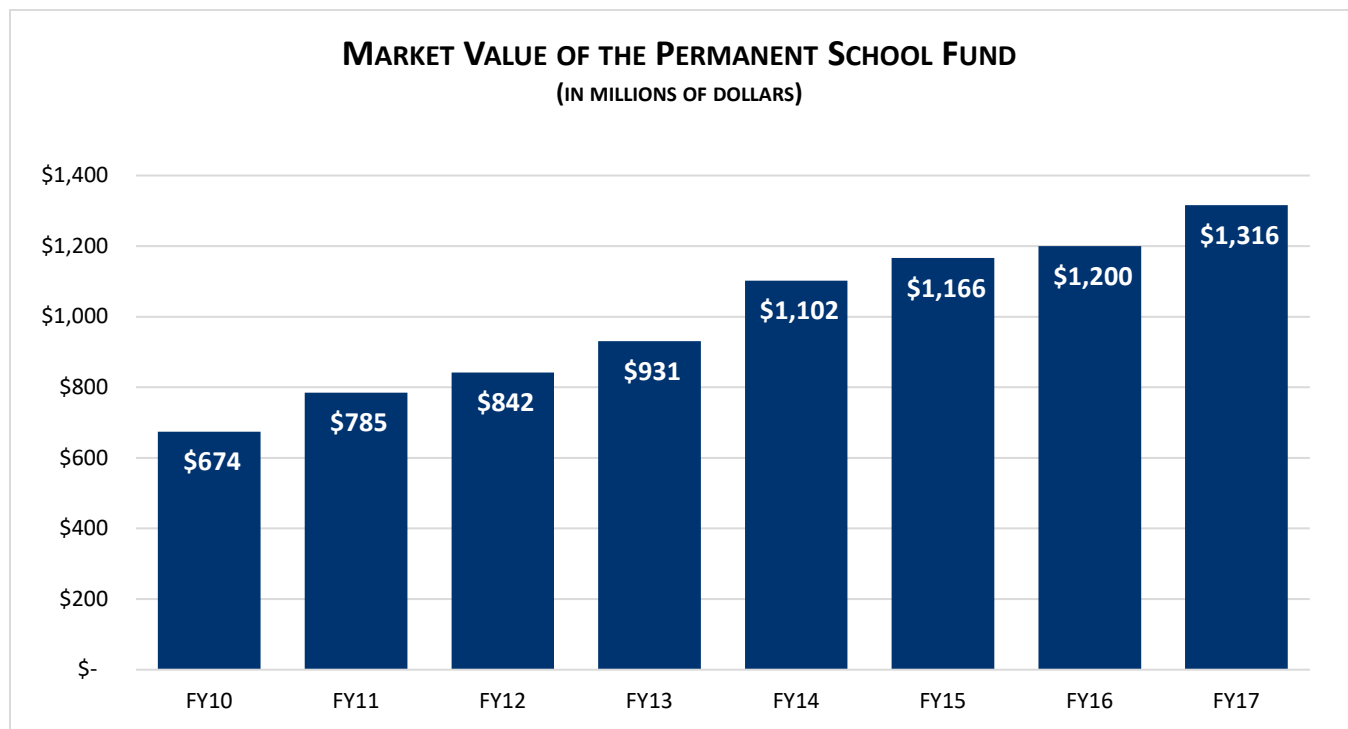


Figure 4. Market Value of the Permanent School Fund

Trustees in Action

State of Minnesota

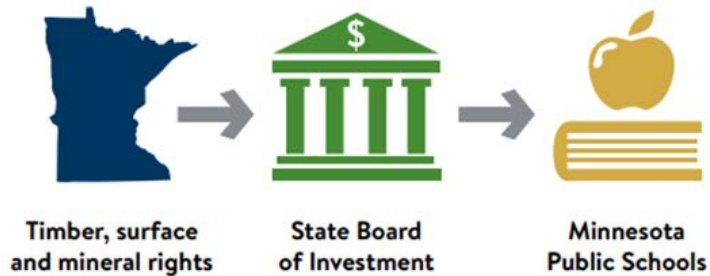
When the State of Minnesota accepted the terms and conditions of the federal land grants, it accepted the position of trustee for school trust lands and the Permanent School Fund (PSF). This relationship also extends to the Minnesota Legislature and other State officials who make decisions affecting the PSF and school trust lands.

Department of Natural Resources

The DNR serves as trustee and retains management authority for the 2.5 million acres of school trust lands and an additional 1 million acres of severed mineral rights on behalf of Minnesota's public schools. The DNR works to manage the diverse portfolio of school trust lands by promoting revenue generation activities that are also protective of the natural resources that Minnesotans enjoy and value. As trustee, the DNR is uniquely positioned to provide experience and knowledge that optimizes the school trust land asset portfolio.

DNR staff come from a wide-range of technical expertise that includes mining engineering, economics, forestry, geology, ecology, biology, and real estate. Staff also work to provide robust land management strategies adaptable to economic and environmental conditions.

How DNR's Work Impacts Minnesota Public Schools



State Board of Investment

The State Board of Investment (SBI) is the agency that manages the PSF and reports on performance. Income earned from school trust lands is added to the PSF principal, which is then invested by SBI.

The PSF, as created by the Minnesota Constitution, is designated as a long-term source of revenue for public schools. In accordance with the Constitution, the principal of the PSF cannot be spent and instead must remain perpetual and inviolate. However, each year SBI distributes PSF interest income and dividends earned from investment to the public schools. The earnings are then transferred to the School Endowment Fund.¹⁰ The Department of Education allocates the funds to school districts based on “the number of pupils in average daily

¹⁰ Minn. Stat., sec. 127A.32

membership during the preceding year.”¹¹ The PSF contributes less than one percent of the total school aid amount appropriated annually by the MN Legislature.

Legislative Permanent School Fund Commission

In 2012, M.S. 127A.30 established a 12-member group called the Legislative Permanent School Fund Commission (LPSFC). The LPSFC is responsible for reviewing legislation and advising the School Trust Lands Director and DNR on management of the lands and the fund. The DNR and School Trust Lands Director provide regular reports to the LPSFC, which then reports annually to the full legislature.

Office of School Trust Lands

Office of School Trust Lands (OSTL) was established by the Minnesota Legislature in 2012 in conjunction with the reorganization of the Legislative Permanent School Fund Commission. The OSTL is led by the School Trust Lands Director. According to their website, the OSTL has three core functions: 1) it advises the Governor, Executive Council, Land Exchange Board and Department of Natural Resources on school trust management activities; 2) it works in conjunction with the Permanent School Fund Commission on legislation to improve school trust assets; and 3) it develops long range strategic plans to ensure school trust resources are optimally managed for current and future beneficiaries.

Minnesota Management and Budget

As part of the responsibilities of the commissioner of Minnesota Management and Budget, there is an annual report that provides an overview of the PSF, reviews recent legislative changes and provides recent transfer totals from the fund to the Department of Education.

¹¹ Minn. Stat., sec. 127A.33

School Trust Revenues

DNR management of school trust land generates revenue from three major categories – mineral leasing and royalty payments, forest management activities, and real estate transactions such as sales. The majority of Minnesota’s school trust revenues ebb and flow with global industry trends and classic economic theory of supply and demand.

Gross Revenues

During the reporting biennium, school trust management activities generated gross revenues (income and receipts) of \$57.98 million from school trust lands and resources.

In FY16 (7/1/15 – 6/30/16), school trust management activities generated gross revenues of \$33.92 million from school trust resources such as minerals, forest products, and land sales. Mineral leasing and royalty payments accounted for \$21.13 million. Forest products and surface leasing contributed \$12.49 million and real estate activities, such as water crossing licenses and school trust land sales, supplied an additional \$302,370.

In FY17 (7/1/16 – 6/30/17), school trust management activities generated gross revenues of \$24.06 million from school trust resources such as minerals, forest products, and land sales. Mineral leasing and royalty payments accounted for roughly \$11.59 million. Forest products contributed \$12.11 million and real estate activities, such as water crossing licenses and school trust land sales, supplied an additional \$357,356.

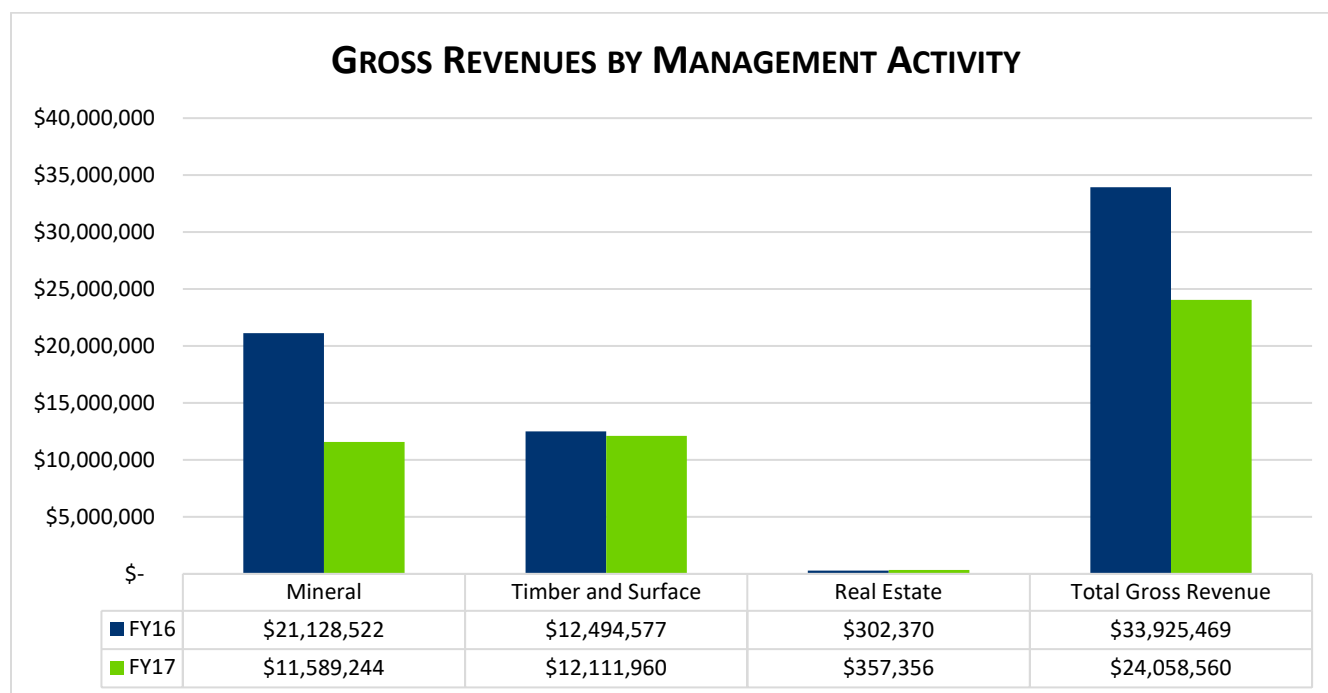


Figure 5. Gross Revenues by Management Activity

School Trust Management Costs

DNR generates revenue on school trust lands from school trust assets (i.e., resources) and transfers revenues and receipts, less expenses allowed under state law, from these management activities into the PSF. The management expenses allowed under state law are described below for minerals management, forest and surface management. Real estate management costs are not allowed to be certified against those proceeds under state law. The general fund provides the majority of subsidy that directly benefits the school trust.

Mineral Management Costs

In 2005, legislative changes permitted the DNR to receive a portion of gross mineral revenues to fund mineral management activities. Pursuant to Minnesota Statutes, section 93.22, twenty percent of mineral receipts are deposited into the Minerals Management Account (MMA) for the administration and management of the entire 12 million acre mineral estate owned by the State of Minnesota, including the 3.5 million acres of school trust mineral rights. The remaining eighty percent of the school trust revenue from mineral leasing is distributed to the PSF, from which the net interest and dividends are distributed to the school districts throughout the state.

Minerals Management Account

The DNR manages the entire mineral estate retained by the State of Minnesota. Minnesota's mineral portfolio includes mineral rights where the state has control of the surface. It also includes mineral rights where another party controls the surface (i.e. severed mineral rights). The DNR manages the mineral estate of multiple land classes (portfolios) such as consolidated conservation lands, Volstead lands, county tax forfeit lands, school trust lands, and university trust lands.

The Minerals Management Account (MMA) was designed to create a \$3 million principal that could be drawn upon in the event that future income generation drops. At the end of each quarter, the amount exceeding \$3 million is distributed to the Permanent School Fund, Permanent University Fund and local taxing districts in the same proportion as the total lease revenue received in the previous biennium from these land ownership classifications. Minnesota Statutes, section 93.2236 states that the DNR can utilize the MMA funds, once appropriated by the legislature, for "mineral resource management and projects to enhance future mineral income and promote new mineral resource opportunities."

Each year, the legislature appropriates money to DNR from the MMA for the administration and management of the state's mineral resources. DNR does not certify its mineral management costs against the gross revenues. The legislature appropriates the funding from the MMA for the DNR operating costs associated with promoting and managing the state's entire 12 million acre mineral portfolio.

Appropriations

Each year the legislature appropriates money to DNR for the operating costs associated with promotion and management of the State of Minnesota's entire mineral portfolio. This includes the administration and management of the entire 12 million acre mineral estate owned by the State of Minnesota, including the 3.5

million acres of school trust mineral rights. DNR does not certify its mineral management costs against gross revenues; instead, the legislature appropriates MMA dollars to DNR per state law to allow for management of the State's mineral portfolio.

The FY16 and FY17 appropriations to the DNR from the MMA are in 2015 Minn. Laws, 1st Special Session, Ch. 4, Art. 3, Sec. 3, Subd. 2. The figure below describes the appropriations from MMA for FY16 and FY17.

FY16 MMA Appropriations	FY17 MMA Appropriations	Comments
\$200,000	\$200,000	For iron ore cooperative research, \$175,000 in each year required match to be available.
\$2,755,000	\$2,815,000	For use as provided in Minnesota Statutes, section 93.2236, paragraph (c), for mineral resource management, projects to enhance future mineral income, and projects to promote new mineral resource

Figure 6. Minerals Management Account Appropriations

Timber and Surface Management Costs

Forestry Certification Process

Minnesota Statutes, section 16A.125 provides which surface management costs can be certified against revenues from school trust lands, and how the certified costs and net revenues from the school trust lands are distributed. The allowable expenses are categorized as improvement, administration, management of forestlands, and for the construction and maintenance of forest roads. Only those charges that were paid from the state's general fund and forest management investment accounts appropriated for the Division of Forestry are included. Costs charged to other funds and federal funds are excluded from the cost certification process.

The Minnesota 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.”

The DNR identifies hours of paid staff time and dollars expended using a set of cost codes for forestry activities. These cost codes identify charges based on the type of activity (e.g., forest improvements, forest inventory, timber sales, surface lease management, etc.), and on the land type on which the activity took place.

More information is presented in the Division of Forestry's annual “M.S. 16A.125 Transfer Certification Report” and is available on the DNR website: www.dnr.state.mn.us/aboutdnr/school_lands/reports.html

Management Subsidy

During the FY12-13 biennium, the DNR completed a full cost accounting analysis of DNR management activities. The objective was to identify all appropriations utilized by DNR to fund trust management activities. The DNR estimated that – at that time – the annual subsidy total was nearly \$7 million for DNR management activities performed to generate an economic return and for non-reimbursable expenses.

The primary non-reimbursable expense of school trust land management is the annual payments in lieu of taxes (PILT) payment made to counties. The FY16-17 general fund subsidy for PILT payments was approximately \$7.5 million. The other management activity subsidies were in the areas of forest management, surface management and real estate management. A conservative estimate of the current subsidy value is easily over \$10 million for the FY16-17 biennium.

DNR Recommendation: Full Cost Accounting – The DNR recommends that during the FY18-19 biennium, the DNR and the OSTL coordinate to develop a joint recommendation on developing a full cost accounting system within the DNR designed to measure the complete, true costs of school trust administration and management activities. This recommendation aligns with OSTL’s focus on the “whole trust” concept.

School Trust Management

Mineral Management

DNR administers the entire mineral estate belonging to the State of Minnesota. This includes mineral rights of the following land types: school trust, university trust, consolidated conservation, Volstead, and tax forfeited lands. The DNR, acting in its trustee capacity, manages the school trust mineral estate for the monetary benefit of Minnesota students and the public education system. The DNR manages the mineral rights for iron ore and taconite production, non-ferrous metallic mineral exploration, dimension stone projects, industrial minerals, stockpiled ore extraction for aggregate use, and peat mining.

Mineral Management Highlights

Iron Ore and Taconite Leasing

Minnesota's iron ore industry is coming out of an economic downturn due to a significant increase in steel imports and a reduction of iron ore pellet prices. During FY16, U.S. Steel Corporation (U.S. Steel) restarted its idled plant in Keewatin after a nearly 20-month shutdown. DNR's leases are now back to unadjusted royalty rates following a 15-month royalty reduction to provide temporary relief to struggling U.S. Steel's Minntac and Keetac mining operations¹². Between its two operations, U.S. Steel currently holds 45 state taconite iron ore mining leases.

The lease amendments modified the base royalty and royalty escalators to provide 15-months of relief to U.S. Steel. The lease amendments also placed a production limit on the amount of state-owned ore mined at the reduced royalty during this 15-month period. The effective date for the lease amendment was April 1, 2015 and ended June 30, 2016.

During the 15-month royalty reduction period U.S. Steel mined 22 million tons of state-owned ore, this tonnage resulted in total revenue for all state lands at Minntac & Keetac of \$16,003,918 million using the rebased indices in the amendment and the second quarter 2015 royalty rate. Revenue without the royalty reduction amendment would have been \$19,787,692. This is a reduction of \$3,783,774 in revenue, or approximately 19 percent. The royalty reduction was enacted as a temporary agreement that would help Minnesota's iron ore compete against imported steel. This allowed U.S. Steel (Minntac), the largest taconite pellet producer mining school trust minerals, to continue operating.

Magnetation, LLC (Magnetation) was an iron concentrate producer that mined under iron ore "scram" permits to recover iron units from existing iron-bearing stockpiles and tailings basins. It began producing from three new plant sites in Keewatin (Plant 1), Holman (Plant 2), and Coleraine (Plant 4) built between 2011 and 2015.

¹² In the first quarter of FY16, Arcelor Mittal, Northshore, and Hibbing Taconite requested similar royalty rate relief as was granted to U.S. Steel, Inc. The relief requested was not granted.

Magnetation had state mineral residue leases at all three operations. The Coleraine site had all but one forty acre parcel under lease in Section 36 (Buckeye Mine) which is school trust land. Magnetation processed and recovered iron from tailings basins and stockpiles from state lands to the north of this site that were originally mined from Section 36 and stored for future use. These concentrates were shipped to Magnetation's iron ore pellet plant in Indiana. Due to a dramatic worldwide drop in the price of iron ore concentrate, the state provided temporary royalty reductions of 18 percent, from April 01, 2015 through June 30, 2016 to help the company to continue to operate. Despite this, Magnetation filed for chapter 11 bankruptcy in May 2015. This bankruptcy resulted in Magnetation's assets being purchased by ERP Iron Ore, LLC (ERP), including the pellet plant in Indiana. The DNR was able to negotiate payment for the past due royalties owed, including school trust royalties. ERP was assigned many of the former Magnetation leases. Once its Indiana plant is ready to restart, ERP intends on producing iron concentrate from their Coleraine plant site.

Essar Steel Minnesota, LLC (Essar) bought the assets of Minnesota Steel Industries, LLC in 2005 and entered into mineral lease negotiations with the State in 2007. Essar had 31 mineral leases on state lands at the former Butler Taconite site (closed in 1985). Essar spent over \$1.2 billion since that time constructing a crusher, concentrator and other facilities which remained unfinished. Essar filed for chapter 11 bankruptcy in 2016. During the bankruptcy, Essar changed its name to Mesabi Metallica Company, LLC. The company's assets were acquired by Chippewa Capital Partners, LLC (Chippewa) through a bankruptcy auction in 2017. Chippewa is seeking financing to complete construction of the initial pelletizing plant. The state entered into lengthy negotiations with Chippewa regarding production guarantees and milestones to ensure completion of the proposed 7 million annual ton pellet operation including 2 million tons of value added direct reduced Hot Briquetted Iron (HBI).

Cemetery Re-Location

An unauthorized "potter's field" cemetery was placed on state land in 1899. The cemetery is located on a forty-acre parcel but the site itself is relatively small, less than an acre, and lies just southeast of Mountain Iron, MN. There was previous iron mining (the Wacootah mine) on the east boundary of the cemetery that ended in 1964. Years of overburden pit wall slumping have endangered the human remains in the cemetery. Due to the slumping endangerment to the cemetery, the DNR Division of Lands & Minerals contacted the State Archeologist for guidance. During FY17, the DNR decided to hire a contractor to perform ground penetrating radar and other geophysical means to ascertain location of possible human burials.

The mineral resources under the cemetery contain significant mineable taconite and iron resources. The parcels immediately north and east of this location are under taconite leases to U.S. Steel (Minntac). Once the process of locating and re-interring the remains is completed, this school trust land may be offered for taconite lease to U.S. Steel. It is estimated that there is over \$25 million in school trust royalty ore that can be mined on this forty-acre parcel.

Industrial Minerals

Under Minnesota law, high-quality dimension stone is classified as an industrial mineral on state lands. Dimension stone is bedrock cut into blocks and slabs to be used in various construction applications, to make monuments, and for decorative stone once polished. Over the past 30 years, DNR geologists spearheaded an

inventory of classifying dimension stone potential on public lands. This inventory considers the suitability and durability of bedrock through a developed methodology consisting of geologic interpretation combined with on-site observations and sampling.

This effort led to the discovery of several dimension stone sites in northern Minnesota, which are operated by Minnesota-based companies. Quarried stone, such as Mesabi Black or Lake Superior Green, have a national market. In fact, these stone products were prominent building materials used in the construction of the 9/11 Memorial Plaza in New York, the National D-Day Memorial in Virginia, and the plaza at the Denver Union Station in Colorado.

As a critical function of school trust land management, DNR continues to capitalize the economic opportunities of dimension stone resources for the trust. In FY16 and FY17, DNR staff oversaw the administration of three recent industrial minerals leases on school trust land with Kasota Stone (Mankato, MN) and Cold Spring Granite (Cold Spring, MN). During the third year of operation, leasing conditions for Kasota Stone Quarry L-259 specifies a guaranteed income of \$150,000 annually to the trust. Payments begin in January 2018. A guaranteed royalty rate benefits the trust by providing long-term revenue streams from royalty payments while incentivizing the company to expand operations over time. Also, DNR staff reviewed and approved an exploration plan submitted by Kasota Stone for Quarry L-159. The company plans to extract test blocks for the purposes of developing a mine plan for the site. A final mine plan will require DNR review from reclamation specialists, legal, and geotechnical staff.

In FY16 and FY17, DNR also launched an inventory of dimension stone potential focused on state trust lands. DNR geologists visited and observed 190 sites on 102 parcels. This information assists DNR in promoting school trust lands for economic development as well as informs land management decisions for the long-term benefit of the trust. Furthermore, identifying dimension stone potential increases the value of the school trust asset portfolio. DNR staff are currently updating our dimension stone inventory database with the newly collected data and are scheduling a public release of this update in FY18.

Non-Ferrous Metallic Minerals Leasing

Three processes are used to issue non-ferrous metallic mineral leases in Minnesota: public auction, negotiation, and preference rights application.¹³ Before the DNR can issue any non-ferrous metallic mineral lease, the proposed lease must be approved by the State Executive Council.¹⁴ During the past biennium, the DNR has held two public auctions and negotiated with one company to lease school trust mineral rights.

In FY16 (7/1/15 – 6/30/16), the DNR held a public lease auction of non-ferrous metallic mineral leases in November 2015. This was the first public lease auction using the retooled comprehensive non-ferrous mineral leasing process to provide more transparency to the public and to provide public input prior to any offer of leasing school trust minerals resources. In June 2015, the DNR published a notice of intent to hold the lease auction, a draft mining unit book and interactive web maps with areas under consideration for lease, its land use

¹³ Minn. R. Part 6125.0500 - .0610.

¹⁴ Minn. Stat., sec. 93.25, subd. 2.

screening criteria and other information. The DNR issued a press release and sent notices to representatives of environmental groups and other interested parties, and accepted public input about the areas under consideration for lease for 60 days. Following its review of the public input, company input and other factors, the DNR removed 13,474 acres under consideration from the lease offering.

At its March 2016 meeting, the State Executive Council approved the DNR's issuance of 43 non-ferrous mineral leases resulting from bids received at the November 2015 public auction. The 43 leases issued cover approximately 16,348 acres in Aitkin, Koochiching and St. Louis counties, of which 50 percent (8,148) of the acres are school trust mineral rights.

In FY17 (7/1/16 – 6/30/17), the State Executive Council approved the DNR's issuance of 14 non-ferrous leases as a result of negotiation. The 14 leases issued cover approximately 6,794 acres in Aitkin and Carlton counties, of which 13 percent (880) of the acres are school trust mineral rights.

During FY17, the DNR also held another public lease auction for non-ferrous metallic mineral leases. The public lease auction was held on June 9, 2017 and 284 mining units covering 112,584 acres received qualifying bids. DNR will recommend that the State Executive Council approve the 284 non-ferrous metallic minerals leases at its September 2017 (FY18) meeting.

Mineral Research

To generate interest in non-ferrous leasing as well as to increase the understanding of the school trust mineral estate, DNR completed a number of geological and geophysical investigations over the course of the biennium. DNR staff devised, contracted, and completed a pilot project to test modern digital techniques for reprocessing existing aeromagnetic data for the state. This effort gleans additional insight into the bedrock geology, especially for the vast areas within the state covered by glacial sediment. The mineral estate of school trust lands is approximated 3.5 million acres. A better understanding of the bedrock geology helps in the speculation of occurrences of undiscovered mineral resources as well as refine inferred mineral resources on school trust Lands. The work was completed with input from the Minnesota Geologic Survey, government, and industry geophysical experts. The data was publically released and available on the DNR website:

www.dnr.state.mn.us/lands_minerals/mpes_projects/project401.html

In FY17, DNR conducted a lithium pilot project conducted solely on school trust lands. Rare earth elements, which include lithium, are classified by the U.S. Department of Energy as a strategic minerals due to our foreign-dependent supply chains and their importance in the production of batteries. Minnesota geology hosts the conditions, like granite terrains and the presence of salt-water brines, for lithium. DNR staff collaborated with academic researchers to refine a methodology that is applicable for Minnesota's rocks. While the initial results show low potential for lithium at sampled sites, our staff have refined a methodology that can be applied to analyze our drill core as well as other sites around the state. Initial results of this project are available on the DNR website: www.dnr.state.mn.us/lands_minerals/mpes_projects/project400.html

DNR geologists continued to define and confirm results in a newly discovered area with high potential for bedrock gold mineralization. Previous biennium work, strongly pointed towards the presence of bedrock gold in proximity of school trust, university trust, and tax-forfeit mineral rights southeast of Soudan. In 2016, analysis using SEM (scanning electron microscope) technology led a third-party contractor to conclude "...a bedrock

source (or sources) must be present within or near the survey area.” Since 2012, a total 191 samples have been collected, with successive phases focusing in on small areas (2-5 square miles). These areas have the highest number of anomalously high gold-grain counts. The purpose of this work is to stimulate investment in and completion for state mineral leases. Interest in exploring within Minnesota has peaked due to on-going research, outreach, and because Minnesota has large, contiguous land packages that are easily accessible with a transportation network. Three gold-in-till data releases were published during the biennium and are available on the DNR website: www.dnr.state.mn.us/lands_minerals/news.html#cookgold

Mineral Encumbrance Negotiations with MNDOT

In 2016, the Minnesota Department of Transportation (MNDOT) notified DNR that U.S. Hwy 169 between Soudan and Ely was to be shortened and straightened for traffic safety purposes. This re-route proposal crossed a section of school trust land that had previously been drilled for iron in the late 1890s to early 1900s. In addition, non-ferrous exploration on this section and adjacent lands has been documented back to the 1870s. In the past 30 years, this area has been explored by numerous companies searching for gold and base metals. The DNR reviewed the iron ore drilling and determined 4 million tons of iron ore resources would be encumbered. Due to the distance from existing mineral processing facilities and type of iron-bearing rock (not currently being processed in existing facilities), the school trust received a reduced amount of \$100,000 for this encumbrance from MNDOT. The DNR also sought payment for encumbrance of non-ferrous minerals, namely possible gold resources. However, the grade and tonnage of such resources is unknown.

Waste Rock Stockpiles

During the FY16-17 biennium, the school trust received over \$400,000 for the use of waste rock iron-bearing stockpiles near the proposed bridge alignment for the new U.S. Highway 53 four land bridge just east of Virginia. Kiewit Infrastructure Company (Kiewit), MNDOT’s contractor for the project, contacted DNR’s Division of Lands and Minerals staff in 2015 to inquire about drilling and blasting subcontract work for the bridge project. The adjacent stockpiles were promoted and made available by DNR to Kiewit. This reduced the cost of the project, saved taxpayer dollars and earned additional revenue for the school trust.

Forest and Surface Management

The Minnesota Constitution establishes that school trust lands, along with other state-owned lands, can be set aside as a special class of productive forest lands and managed on forestry principles.¹⁵ DNR has implemented a forest management approach that addresses all state-owned lands as one group. Managing the state’s forestlands as a group is beneficial to the school trust because many efficiencies are realized which increases the net revenue from forests. The 2.5 million acres of school trust lands account for 45 percent of all DNR managed forestry lands.

¹⁵ Minn. Const. Art. XI, sec. 11.

The overarching forest management strategy differs significantly from many private timber managers. DNR recognizes the symbiotic relationship between school trust lands and Minnesota's economy. While private timber companies may elect to hold their timber off the market when prices are low, the DNR approach is to continue to offer school trust timber resources for two main reasons. First, continuing to offer school trust timber resources is the primary means by which DNR can manage the health of the school trust's forested lands. Secondly, maintaining harvest levels helps ensure that a viable forest products industry will remain in Minnesota, thereby protecting the long-term value of the trust's timber resource assets. These strategies make sense currently. If there is a change in the future economic condition, our strategy may change as well.

Forest and Surface Management Highlights

Timber Management

DNR timber management activities generate revenue across a number of fiscal years. The initial revenue is a 15 percent down payment, based on the appraised value of the permit made at the time of sale at a public auction. The remaining value of the timber permit is a required payment in the form of cash or documentary credit before the high bidder begins the harvest. The actual value of timber harvested is then invoiced on a quarterly basis until the harvesting is completed. Timber permits have between a three-year and five-year lifespan with ability for a one-year extension, if requested.¹⁶ Timber sale management is directed by statute (Chapter 90).

In FY16 (7/1/15 – 6/30/16), DNR offered 973,200 cord equivalents, sold 882,600 cord equivalents, and scaled (volume or weight measurement of harvested wood) 727,200 cord equivalents of all species, products, and units of measure across all DNR managed lands. DNR sold 427,468 cords equivalents and scaled 350,830 cord equivalents of school trust timber resources in FY16.

In FY17 (7/1/16 – 6/30/17), DNR offered 967,000 cord equivalents, sold 866,900 cord equivalents, and scaled (volume or weight measurement of harvested wood) 701,900 cord equivalents of all species, products, and units of measure across all DNR managed lands. During FY17, DNR sold 428,655 cords equivalents and scaled 328,519 cord equivalents of school trust timber resources.

The above information is presented in the annual Division of Forestry's "M.S. 16A.125 Transfer Certification Report" and is available on the DNR website: www.dnr.state.mn.us/aboutdnr/school_land/reports.html

Sustainable Timber Harvest Analysis (STHA)

Good forest management includes periodic review of timber harvest levels and their impact to the greater forest ecosystem and economy. Governor Dayton requested the DNR analyze the sustainability of harvesting one million cords of timber per year from DNR-managed forestlands. If the analysis determined that an annual harvest of one million cords was not sustainable, the governor asked DNR to identify an alternative sustainable

¹⁶ Minn. Stat., sec. 90.193.

harvest target. Mason, Bruce & Girard (MB&G), an independent contractor, conducted the analysis and a stakeholder advisory group provided input.

STHA was a transparent stakeholder process utilizing a 14-member stakeholder advisory panel. In addition, the OSTL was engaged as a direct advisor in the process.

More than 140 individuals or groups provided comments that were shared with MB&G for consideration in their final report; the DNR also considered these comments in making the harvest level decision.

DNR strives to provide a stable, quality source of wood fiber to industry in a manner that is sustainable and conserves Minnesota's state forest resources into the future. A variety of environmental and economic factors were considered in the analysis. The final MB&G report provides important benchmarks for the amount of timber harvested from DNR-managed forest lands.

DNR thought it was important to conduct an independent third party analysis. The department contracted with MB&G to complete the modeling and analysis work for this project. Last summer, MB&G developed a "Phase I" progress report on the initial work for this project. That initial work was used as a launching point into more in-depth modeling and analysis that resulted in the "Phase 2 Sustainable Timber Harvest Analysis Draft Report." DNR created an introductory video to help explain how the analysis was conducted. After public comment and stakeholder group input, the MB&G final report was issued in February 2018.

After more than a year of rigorous scientific analysis, discussions with key partners, including conservation organizations and forest industry, and public input, DNR has set a new 10-year sustainable timber harvest at 870,000 cords offered for sale annually from DNR-managed forest lands. Under the sustainable timber harvest target of 870,000 cords annually, DNR-managed forest lands will continue to sustain Minnesota's rich biodiversity, provide healthy, thriving wildlife habitat, support our state economy, contribute to clean air through carbon storage, and keep our water clean.

Beyond the 870,000 cords, DNR will also launch a special five-year initiative that could offer up to 30,000 additional cords of ash and tamarack annually in response to the threat posed by emerald ash borer and eastern larch beetle. Forest Health professionals suspect that these two insects will decimate Minnesota's ash and tamarack forests. The DNR is accelerating its harvest to capture value before the trees are killed. The DNR will reforest the sites.

All of the information found above and pertaining to the STHA is available on the DNR website:

www.dnr.state.mn.us/forestry/harvest-analysis/index.html

Forest Investments

During the 2017 Minnesota Legislature, additional resources were budgeted for forest improvements. An additional \$2 million was appropriated for reforestation and timber stand improvement and \$500,000 was appropriated for investments in state forest roads.

It is important to understand that these investments are a cost to the school trust and will appear as expense on future forest certification reports. The result will be reduced net revenue in future years. However, these

investments to improve the health of school trust forests and forest access will increase future gross revenue which will eventually offset the short-term costs.

Forestry investments are by nature long-term investments. Money spent on reforestation and stand improvement will not begin to return revenue for many years. Investments in roads also increase the value of school trust timber by allowing summer access in the future. Summer accessible timber usually holds a premium over winter accessible timber.

Forest Management Guidelines Project

In FY16, the DNR's School Trust Land Working Group began work to create department-wide guidance for forest management on school trust lands. The goals of the guidelines are to provide: 1) direction to staff to ensure forest management decisions continue to align with school trust objectives, 2) a framework for informed and consistent decision-making, 3) a structure for compensation, 4) a process for dispute resolution, and 5) procedures to proactively address emerging issues that have the potential to affect school trust forest assets.

Providing more prescriptive, site-based forest management guidelines on school trust lands is in the best interest of trust. The guidance will enhance maximization of long-term economic return to the trust while ensuring that forest management activities are clear, balanced, and defensible when following sound natural resource conservation and management principles. The project outcomes also intend to reduce the number of irresolvable conflicts between maximizing the long-term economic return and protecting natural resources and recreational values on school trust lands (M.S. 84.027, subd. 18).

Landscape Approach for Managing School Trust Lands – SFRMP Pilot

The DNR's Section Forest Resource Management Planning (SFRMP) planning process offers the greatest opportunity to increase efficiencies in cost while optimizing revenue from the school trust timber assets (i.e., timber resources). As such, this pilot project will set out to assess the feasibility and effectiveness of using a landscape-level approach to forest management on school trust lands.

SFRMP's are landscape-level vegetation management plans that provide 1) strategic forest management direction for balancing multiple-use objectives, 2) operational 10-year lists of stands to be examined for timber harvest, and 3) identify geographically specific "special management areas" where management may differ from the surrounding landscape. School trust lands are included with other DNR forestlands in the planning and stand selection process, but are uniquely identified in the dataset so that they can be treated and summarized separately. The pilot project will develop a benchmark harvest scenario for school trust lands and compare it to the final SFRMP 10-year stand list to evaluate the need to compensate the trust for any loss of revenue.

DNR proposes piloting this landscape approach as part of the Northern Minnesota and Ontario Peatlands (NMOP) and Northern Superior Uplands (NSU) SFRMP's. The NMOP and NSU SFRMP's encompass 65 percent of the productive school trust timberlands in the state. These two SFRMP revisions were underway when put on hold pending completion of the DNR Sustainable Timber Harvest Analysis. These two plans will be revised and finalized based on the identified statewide sustainable harvest level.

DNR Recommendation: SFRMP Pilot – DNR recommends that during the FY18-19 biennium, the DNR and the OSTL coordinate to develop a “school trust land benchmark” to be used in NMOP and NSU SFRMP’s. This benchmark allows DNR to operationalize “sound natural resource conservation and management principles” by establishing landscape-level constraints and assumptions for school trust land management and resource management in the SFRMP process.

Real Estate Management

As part of its real estate management activities, the DNR enters into various real estate contracts on school trust lands. The DNR generates revenue from school trust lands through lease contracts,¹⁷ easements,¹⁸ and licenses.¹⁹ Additional revenue is generated through public auctions (land sales) of school trust lands.²⁰ In addition, the DNR enters into land exchanges²¹ that reposition the school trust lands to consolidate surface ownership, improve management, reduce management costs, and to improve opportunities for future revenue potential.

Revenues deposited in the Forest Suspense Account from forest management subject to forestry cost certification per M.S. 16A.125 are not limited to timber sales and mineral resource permits. Revenues are also generated from lease transactions (aggregates, agriculture, hunting cabins, miscellaneous commercial and government, and lakeshore), permits (resource management access, and grant-in-aid), easements (primarily for right-of-way), and utility licenses (land and water crossings). Water crossing licenses,²² wild rice farming leases, and state forest campground revenues are not subject to forestry cost certification under M.S. 16A.125 and are directly deposited into the PSF.

In addition, for the FY16-17 biennium, the legislature appropriated \$200,000 each fiscal year from the Forest Suspense Account to accelerate leasing, land sales and land exchanges, and for the identification, evaluation and leasing of aggregate resources.²³

Real Estate Management Highlights

Strategic Land Asset Management (SLAM) Program

Minnesota's economy and quality of life are heavily dependent on our public lands and the DNR has been entrusted to manage those lands to provide a variety of benefits to stakeholders. The DNR is responsible for the management of multiple land classes or land portfolios. Strategic Land Asset Management (SLAM) is the statewide framework used by DNR staff to continuously evaluate and improve the multiple land portfolios

¹⁷ Minn. Stat., secs. 84.153 (residences); 89.17 (forest use); and 92.50 (miscellaneous)

¹⁸ Minn. Stat., sec. 84.63.

¹⁹ Minn. Stat., sec. 84.415.

²⁰ Minn. Stat., sec. 92.12.

²¹ Minn. Stat., sec. 94.343.

²² Laws of Minnesota 2009, Chapter 37, Article 1, section 12 amending Minnesota Statutes, section 84.415 to require licenses and permits for the use of the beds of public waters be credited directly to the Permanent School Fund.

²³ Laws of Minnesota 2011, First Special Session, Chapter 2, Article 1, section 4, subd. 2.

managed by DNR. The agency also strives to strengthen the position of land assets, reduce land-management costs and find efficiencies where possible.

SLAM seeks to optimize the use of DNR-managed lands within the context of all Minnesota's public lands and focuses on collaboration between DNR, other public land managers, and stakeholder groups. Staff members are directed to evaluate land decisions in the context of six goals, three of which relate directly to improving the school trust land portfolio. They are 1) meet our fiduciary responsibilities on trust lands; 2) consolidate state land into larger, contiguous blocks; and 3) improve access to existing land holdings.

Information on Strategic Land Asset Management (SLAM) is available on the DNR website:

www.dnr.state.mn.us/slam/index.html

Land Exchanges

During FY16, the DNR completed one land exchange involving school trust land. The SLAM program land exchange received Land Exchange Board (LEB) approval in December 2015. The land exchange was a partnership between the school trust and Kanabec County. It involved 1,963 acres of school trust land and 2,180 acres of county tax-forfeited land, both valued at \$1,960,000. This land exchange consolidated ownerships of both parties, provided new access to timber, reduced management costs through consolidation and managed boundary reductions, and improved relations with our county partners and local community members.

During FY17, DNR did not complete a school trust land exchange. However, DNR made significant progress on a large land exchange involving school trust lands through its SLAM program. The project is located in southern St. Louis County and involves almost 15,000 acres of public land. LEB approval is expected by the end of CY 2018.

DNR Recommendation: School Trust & County Land Exchange – DNR recommends that during the FY18-19 biennium, the DNR and OSTL coordinate to develop a joint recommendation for a school trust land exchange with an interested county partner.

Land Sales

Minnesota Statutes, section 92.12 requires that the DNR hold frequent sales of school trust lands and other state-owned lands. Revenue generated from the public auction²⁴ of school trust lands is not subject to forest cost certification under Minnesota Statutes, section 16A.125.

In order to comply with the constitutional and statutory requirements to offer school trust land at public auction, the DNR incurs operating expenses for professional services related to survey, appraisal, legal, advertising, and other fees on behalf of the school trust.²⁵

The minimum bid price for school trust lands offered at public auction, therefore, includes the appraised value and most of the related sale expenses. The department is able to pass on some of the related costs to the

²⁴ Minn. Const. Art. XI, Sec. 8 requiring that school trust lands be sold only at public auction.

²⁵ Minn. Stat., sec. 94.16.

bidder, if someone purchases the land. If no one purchases the land, those costs become sunk and must be funded using other sources, usually general fund dollars. When a school trust parcel sells at public auction, pursuant to Minnesota Statutes, section 94.16, the DNR deposits the high bid amount won into the PSF. Given that school trust land can only be sold at public auction and not over the counter, DNR incurs the expenses for all unsold parcels and incurs additional costs to reoffer unsold school trust land at subsequent public auctions.

In the FY16-17 biennium (7/1/15 – 6/30/17), there were six school trust parcels offered at public sale which won proceeds in the amount of \$383,632. All parcels were bid on and some were bid up over the minimum purchase price. Due to competition in the bidding process, the school trust received approximately 25 percent more in sales revenues.

DNR Recommendation: Land Sales Program – DNR recommends that during the FY18-19 biennium, DNR and OSTL coordinate and develop a joint recommendation for strategies to improve the school trust land sale program and for the school trust to support its land sales program and related costs. The DNR currently subsidizes much of this activity, usually with general fund dollars.

Recreational Uses

The DNR leases school trust land for recreational purposes. The revenues generated from recreation leases are subject to forest cost certification under Minnesota Statutes, section 16A.125. Examples of such recreational leases are Hill Annex State Park, Knife River Marina, North Country hiking trail, and Superior hiking trail.

The DNR also manages forest campgrounds located on school trust lands. In FY16, total revenue generated from campground fees was \$195,191. In FY17, total revenue generated from campground fees was \$218,187. The

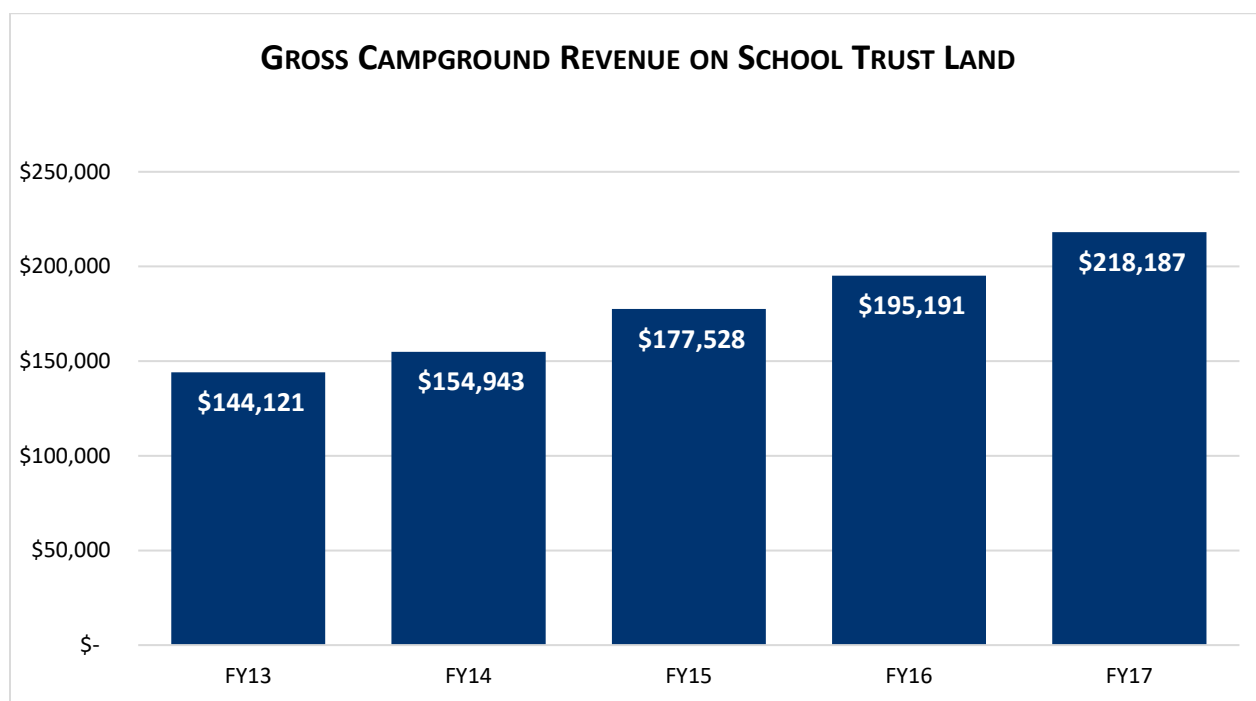


Figure 7. Gross Revenues from Campgrounds

revenue generated from forest campgrounds is not subject to forest cost certification under Minnesota Statutes, section 16A.125. Thus, the DNR pays the costs of operating forest campgrounds on school trust lands from other sources. These operational costs should be supported from the school trust revenues. All gross revenues from forest campgrounds are deposited in the Forest Suspense Account as a pass through prior to being deposited into the Permanent School Fund.

In the FY14-15 biennium, \$332,471 of forest campground revenues were directly desposited into the PSF. During this reporting FY16-17 biennium, the total forest campground revenues deposited were \$413,378. The data demonstrates an increase in revenues of 24 percent from the FY14-15 biennium to the FY16-17 biennium, mainly due to the Division of Parks and Trails increase of campground fees.

The DNR is receiving increased interest from user groups and stakeholders who would like investments in certain forest campgrounds, in Forest Recreation Areas, to improve services and provide higher level amenities, especially related to motorized recreation. To do this, a solution is needed to capture the cost of management and operating expenses. DNR would like to be responsive to our user groups while increasing revenues to the school trust. It is hard to justify increasing investments to campgrounds on school trust lands when there is no legislative authority for DNR to recover costs related to capital improvements and operating expenses.

DNR Recommendation: Forest Campground Improvements – During the FY18-19 biennium, the DNR recommends the DNR and OSTL coordinate to develop a joint recommendation on a process to capture operating expenses and costs related to investment and improvements to school trust campgrounds in Forest Recreation Areas.

Construction Aggregate Resources Inventory and Promotion

Identification and development of construction aggregate resources (sand and gravel) is one of the ways the trust generates revenue for Minnesota's public schools. The DNR offers leases, called earth material leases, to private entities and local governments for the commercial production of construction aggregate resources (sand, gravel, crushed stone and landscape stone). During the FY16-17 biennium, earth materials leases on school trust lands produced \$554,209 in gross revenues. Gross revenues from rental payments and material sales royalties are deposited in the Forest Suspense Account and are subject to cost certification pursuant to Minnesota Statutes, section 16A.125. For earth materials leases, the lessee pays a royalty (based on DNR rate standards) for every unit of weight (ton) or volume (cubic yard) of material removed from the site.

Approximately 21,000 school trust parcels were inventoried for sand, gravel or crushed stone potential during the reporting period. The purpose of the inventory project is to evaluate and label the construction aggregate resource potential of each school trust parcel to inform transactions and land management decisions. DNR geologists evaluate aggregate potential by combining technical expertise with cost-effective, electronic, modernized methods to analyze geologic data, gravel pit records, elevation data and historic field observations. Occasionally, fieldwork is required to determine aggregate potential.

To promote the potential leasing of school trust aggregate resources, the DNR has developed the “School Trust Aggregate Finder” application. This tool is an interactive web map that advertises school trust parcels identified during the inventory project which may contain valuable sand and gravel deposits. The DNR’s goal is to help public transportation administrators and private companies locate aggregate prospects faster, and improve public recognition of school trust resource lease opportunities.

Information on the inventory project and the “School Trust Aggregate Finder” application is available on the DNR website: www.dnr.state.mn.us/lands_minerals/aggregate_leasing/aggregate_finder.html

Boundary Waters Project

The information in this section and offered below, including additional project information and maps, is available on the Office of School Trust Lands website: mn.gov/school-trust-lands/projects/boundary-waters/

Background

The State of Minnesota, Superior National Forest, and The Conservation Fund are working together on a mutually beneficial strategy to transfer ownership of school trust lands located within the Boundary Waters Canoe Area Wilderness (BWCAW) to federal ownership. Minnesota's school trust beneficiaries are entitled to the economic benefits from the lands that were granted at statehood to support public education. This project will resolve the decades-old controversy of school trust lands within the BWCAW that originated with the 1964 Wilderness Act and subsequent passage of the 1978 BWCAW Act that confined approximately 83,000 acres of school trust lands within the wilderness area.

Hybrid Model

Beginning in 2009, the Minnesota Legislature's Permanent School Trust Fund Advisory Committee (now known as the Legislative Permanent School Fund Commission) appointed a working group to develop a strategy to meet the land management goals of both the School Trust and the Forest Service. The working group consisted of a cross-section of interested stakeholders from the education and environmental communities, mining and timber industries, county government, and representatives from the Forest Service and the Minnesota Department of Natural Resources (DNR). This work group devised and recommended the "Hybrid Model" comprised of a one-third land exchange and two-thirds land sale. The Minnesota Legislature passed Resolution No. 1 during its 2010 session supporting the Hybrid Model, and the Governor of Minnesota signed legislation in 2012 to expedite it. The hybrid proposal calls for one-third of the school trust lands to be exchanged for equally valued federal lands outside the BWCAW and envisioned the Forest Service purchasing the remaining two-thirds of school trust lands in the BWCAW.

In August 2012, the Minnesota DNR formally proposed a land exchange consistent with this collaborative framework and legislation. The initial phase of the project would exchange one-third of the school trust lands within the BWCAW (approximately 31,000 acres) for an equal value of federal lands outside of the BWCAW from a federal candidate pool of approximately 39,000. Candidate federal parcels were identified by the working group during the collaborative process.

The legislative mandate for school trust lands is to manage them for maximum long-term economic return while maintaining sound natural resource conservation and management principles. This mandate directly contradicts the wilderness laws and regulations implemented by the Forest Service in the BWCAW. The intent of the land exchange is to convey lands without wilderness restrictions to the School Trust. At the same time, the Forest Service would consolidate land ownership within the BWCAW to protect the wilderness resource.

Initiating a land exchange required a feasibility analysis of the proposal. The feasibility analysis is a screening tool that evaluates whether the proposal supports the standards and guidelines of the Superior National Forest Land and Resource Management Plan. The Forest Service completed its feasibility analysis for the school trust land exchange in May 2014 with a recommendation to proceed with the proposed exchange.

Since then, the proposed land exchange has undergone environmental analysis pursuant to the National Environmental Policy Act. The Forest Service published its Draft Environmental Impact Statement in August 2017 and continues to work towards issuing its final environmental impact statement and draft record of decision during 2018. Concurrently, the Forest Service also will be completing an appraisal of school trust lands within the BWCAW. A land exchange project goal is to seek approval from the Land Exchange Board in 2018 once the Forest Service completes the appraisal and issues its final record of decision.

Private Forestland Alternative

The Hybrid Model also called for the land sale/federal acquisition of the remaining two-thirds of school trust land within the wilderness area. Until fiscal year 2018, the Forest Service had been unsuccessful in obtaining project funding even though the BWCAW project continues to rank high on Forest Service priorities both regionally and nationally. Based on the lack of federal funding to condemn the school trust lands, the State of Minnesota and Superior National Forest sought a partnership with The Conservation Fund to resolve the lack of funds for the remaining two-thirds land sale portion of the Hybrid Model.

This new partnership, emulating the successful Sax-Zim Bog land exchange, advanced the “Plan B: Private Forestland Alternative.” The Plan B partnership envisions The Conservation Fund (TCF) acquiring industrial timberlands in St. Louis County. Once acquired, the State and TCF will enter into a multi-year land exchange for school trust lands located within the BWCAW for TCF industrial timberlands. Finally, TCF will sell the former school trust lands to the Superior National Forest.

The state/federal/TCF partnership demonstrated immediate success as evidenced by an initial \$4 million dollar federal appropriation for phase one of the multi-year Plan B process. Since the BWCAW project competes nationally against other conservation projects, the Office of School Trust Lands will continue to work collaboratively with our partners to advocate for the project and encourage the Forest Service and Congress to prioritize federal funding in an effort to convey the school trust ownership in the BWCAW.

The information in this section and offered above, including additional project information and maps, can be found on the Office of School Trust Lands website: mn.gov/school-trust-lands/projects/boundary-waters/

School Trust Promotion and Outreach

DNR staff spent significant time conducting outreach and communication efforts during the biennium. Topics ranged from role of the DNR as trustee, mineral potential of the school trust lands, and land asset management. DNR used our available platforms to reach broad-ranging audiences across the state. Outreach efforts include state fair displays, newspaper and television interviews, and technical presentations at professional conferences, a selection of which are listed below.

- In FY16 and FY17, DNR created and displayed two state fair exhibits communicating the role of minerals in funding the PSF. An estimated 800,000 people visit the DNR state fair building annually.
- DNR work and staff were featured in a number of newspaper articles and magazines which promotes the benefits of minerals, mining, and research for the school trust lands:
 - 07/01/15 Duluth News Tribune/St. Paul Pioneer Press: *Eureka! DNR Strikes More Gold Near Lake Vermillion*
www.duluthnewstribune.com/news/3777887-eureka-dnr-strikes-more-gold-near-lake-vermilion
 - 01/26/16 Star Tribune: *Gold on the Iron Range? Results of soil tests are raising hopes.*
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 - 09/01/2016 WCCO TV live interview at the MN State Fair:
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 - 06/15/2017 KBJR CBS3 Duluth: *Eye on Mining: Exploring the Road to Gold*
webpage: www.cbs3duluth.com/story/35505066/eye-on-mining-exploring-the-road-to-gold
video: http://kbjr6cbs.videodownload.worldnow.com/KBJRCBS_20170524092515727AA.mp4

Recommendations

Stakeholders may consider the recommendations found below and how they contribute to important components of school trust administration, such as: transparency in school trust management, DNR's continuous improvement efforts, responsible land management, and strategic positioning to strengthen the school trust portfolio.

The following DNR recommendations are offered in this report and listed below in priority order:

1. ***DNR Recommendation: Full Cost Accounting*** – The DNR recommends that during the FY18-19 biennium, the DNR and the OSTL coordinate to develop a joint recommendation on developing a full cost accounting system within the DNR designed to measure the complete, true costs of school trust administration and management activities. This recommendation aligns with OSTL's focus on the "whole trust" concept.
2. ***DNR Recommendation: Forest Campground Improvements*** – During the FY18-19 biennium, the DNR recommends the DNR and OSTL coordinate to develop a joint recommendation on a process to capture operating expenses and costs related to investment and improvements to school trust campgrounds in Forest Recreation Areas.
3. ***DNR Recommendation: SFRMP Pilot*** – DNR recommends that during the FY18-19 biennium, the DNR and the OSTL coordinate to develop a "school trust land benchmark" to be used in NMOP and NSU SFRMP's. This benchmark allows DNR to operationalize "sound natural resource conservation and management principles" by establishing landscape-level constraints and assumptions for school trust land management and resource management in the SFRMP process.
4. ***DNR Recommendation: Land Sales Program*** – DNR recommends that during the FY18-19 biennium, DNR and OSTL coordinate and develop a joint recommendation for strategies to improve the school trust land sale program and for the school trust to support its land sales program and related costs. The DNR currently subsidizes much of this activity, usually with general fund dollars.
5. ***DNR Recommendation: School Trust & County Land Exchange*** – DNR recommends that during the FY18-19 biennium, the DNR and OSTL coordinate to develop a joint recommendation for a school trust land exchange with an interested county partner.

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