Minnesota's School Trust Lands

Biennial Report

Fiscal Years 2004-2005
(7/1/2003 - 6/30/2005)

Minnesota Department of Natural Resources

March 2006

Message from the DNR Commissioner

Our children and our natural resources are two of Minnesota's most important treasures. Children in our state are linked with natural resources in many ways. Among these are 2.5 million acres of school trust lands, and an additional one million acres of school trust mineral rights managed by the Department of Natural Resources. These trust lands have yielded millions of dollars for education since 1862 through land and timber sales, leases, and mining royalties. The proceeds are deposited in the Permanent School Fund (PSF), which invests the money and supports the annual budgets of each school district in the state. This funding is an important piece of annual education spending in our state.

The people of Minnesota have entrusted state government with the wise management of these land and mineral resources. This responsibility resides with the Legislature, with the DNR to manage the land and mineral resources, with the State Executive Council to approve mineral leasing activities, with the PSF Advisory Committee to review DNR's management and recommend changes, and with the State Board of Investment and the Department of Finance to manage the PSF.

Since 2002 the DNR has prepared a biennial report on how school trust land is being managed. This is the third biennial report. I hope you will benefit from reading it and learning more about how these school trust lands and mineral rights benefit Minnesota's children.

Gene Merriam, Commissioner

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[Cover photo: a Minnesota taconite processing facility]

Excecutive Summary

The Department of Natural Resources (DNR) manages 2.5 million acres of school trust lands, and an additional one million acres of school trust mineral rights. Revenue derived from these lands and minerals is deposited in the Permanent School Fund, with mining royalties, timber sales, land sales and surface leases providing most of the revenue. In FY04, gross revenue from these activities totaled \$17.6 million, and net revenue was \$11.8 million, 94% of which came from timber sales and mineral leases. In FY05, gross revenue was \$22.3 million, and net revenue was \$16.2 million. The big increase in FY05 revenue was the result of increased mining activity in Minnesota, which was driven in large part by increased demand from China for taconite pellets: from FY04 to FY05, school trust minerals revenue increased almost \$6 million.

The DNR continues to explore ways to increase revenue generation from trust lands, and two projects authorized by the Legislature in FY04-05 are now underway; the aggregate inventory project, and the trust fund revenue enhancement project. The goal of the aggregate inventory project is to increase revenue generation from the sale of construction aggregates located on trust lands. As part of this effort, the DNR is working with the Department of Transportation (DOT) to identify aggregate deposits on trust land that may be used in future highway projects.

The trust fund revenue enhancement project also attempts to increase revenue generation from school trust lands. Two pilot areas (in Pine County and St. Louis County) have been identified for intensive study, which will include analysis of timber productivity, mineral and gravel potential, natural heritage features, wetland characteristics, cultural resources, water frontage and other information.

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

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

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

Table 1. School trust land by type of grant.

Type of grant	Original [A] acres granted	Acres as of 12/31/05
School	2,900,000	958,392
Swamp	4,706,503	1,551,438
Internal Improvement	500,000	6,629
Total	8,106,503	2,516,459

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

1 Matthias Nordberf Orfield, Federal Land Grants to the States with Special Reference to Minnesota. (Minneapolis, University of Minnesota, 1915). p. 7-13.
2 Ibid., p. 37
3 Minnesota's Legislature, Office of the Legislative Auditor, School Trust Land, A Program Evaluation Report (St. Paul, 1998), p.3; Orfield. p. 42-44.
4 Act of Congress, March 3, 1849, 9 Stat. ch. 121, section 18.
5 Act of Congress, February 26, 1857, 11 Stat. ch. 60, section 5, first paragraph.

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

2. Minnesota's trust land today.

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

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

3. Revenue from school trust lands, FY04-05.

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

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

7 Ibid., p. 14-15.

8 Office of the Legislative Auditor, p. 18.

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

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

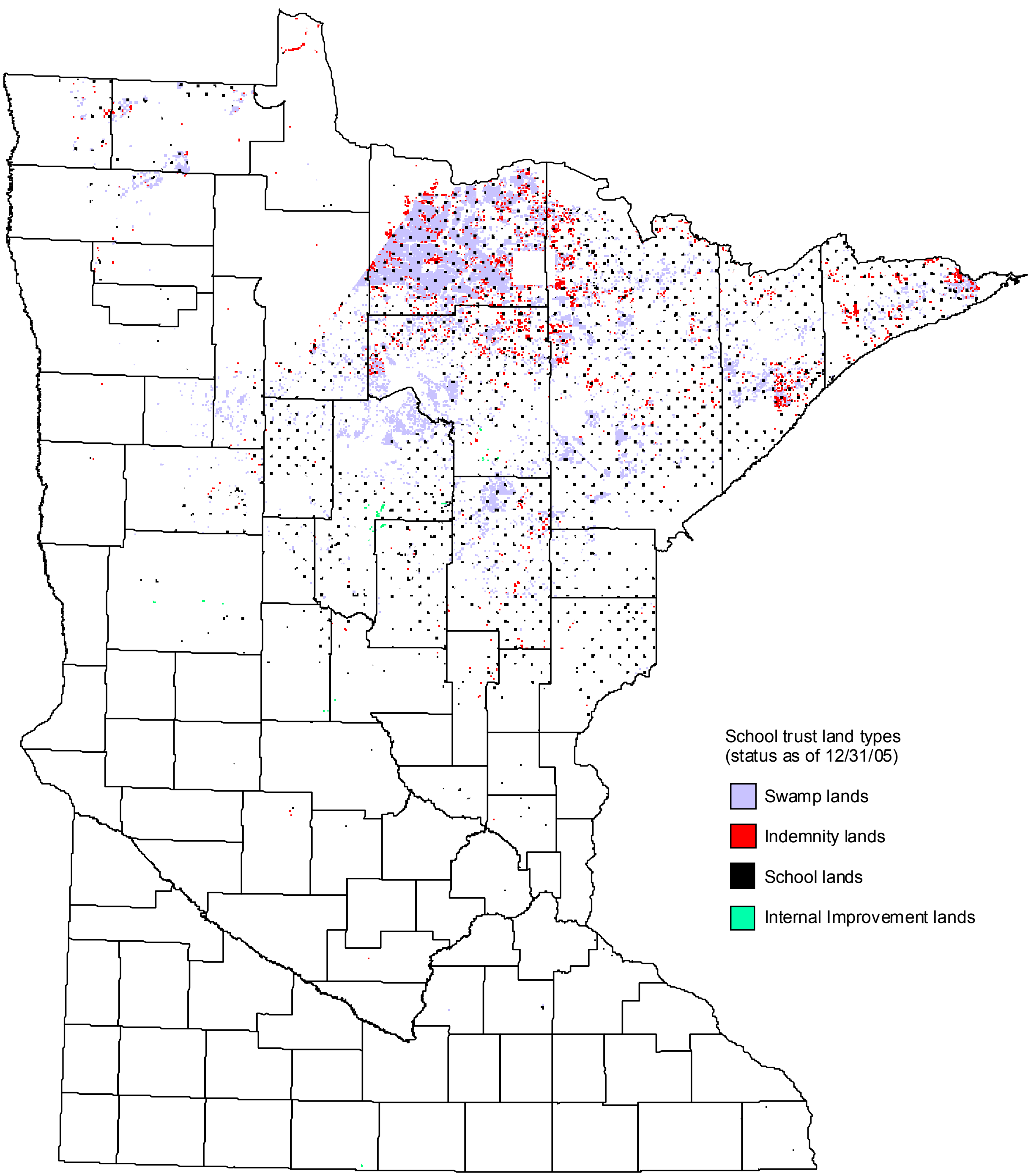


Figure 2. Map of Minnesota school trust land and school trust severed mineral rights.

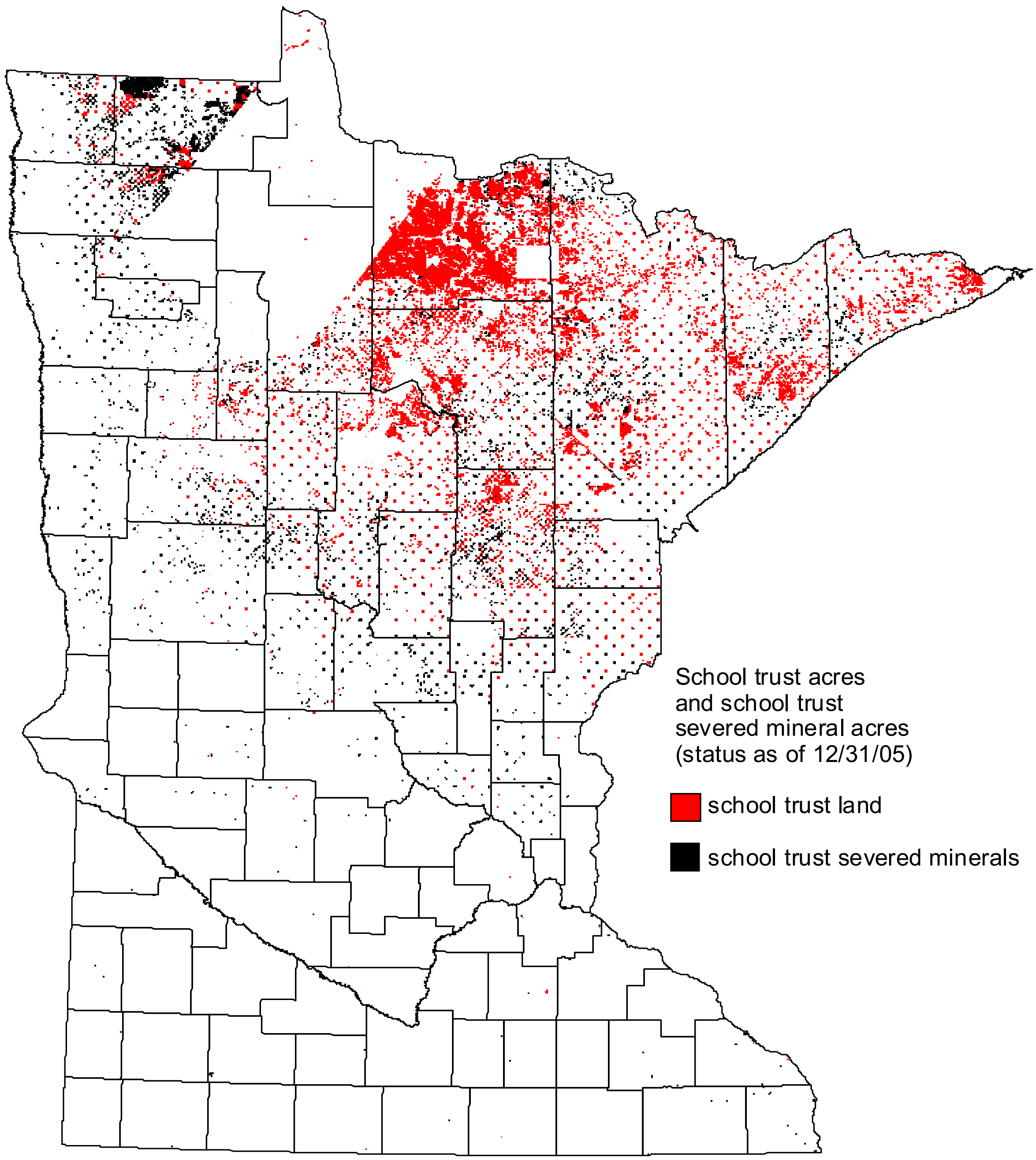
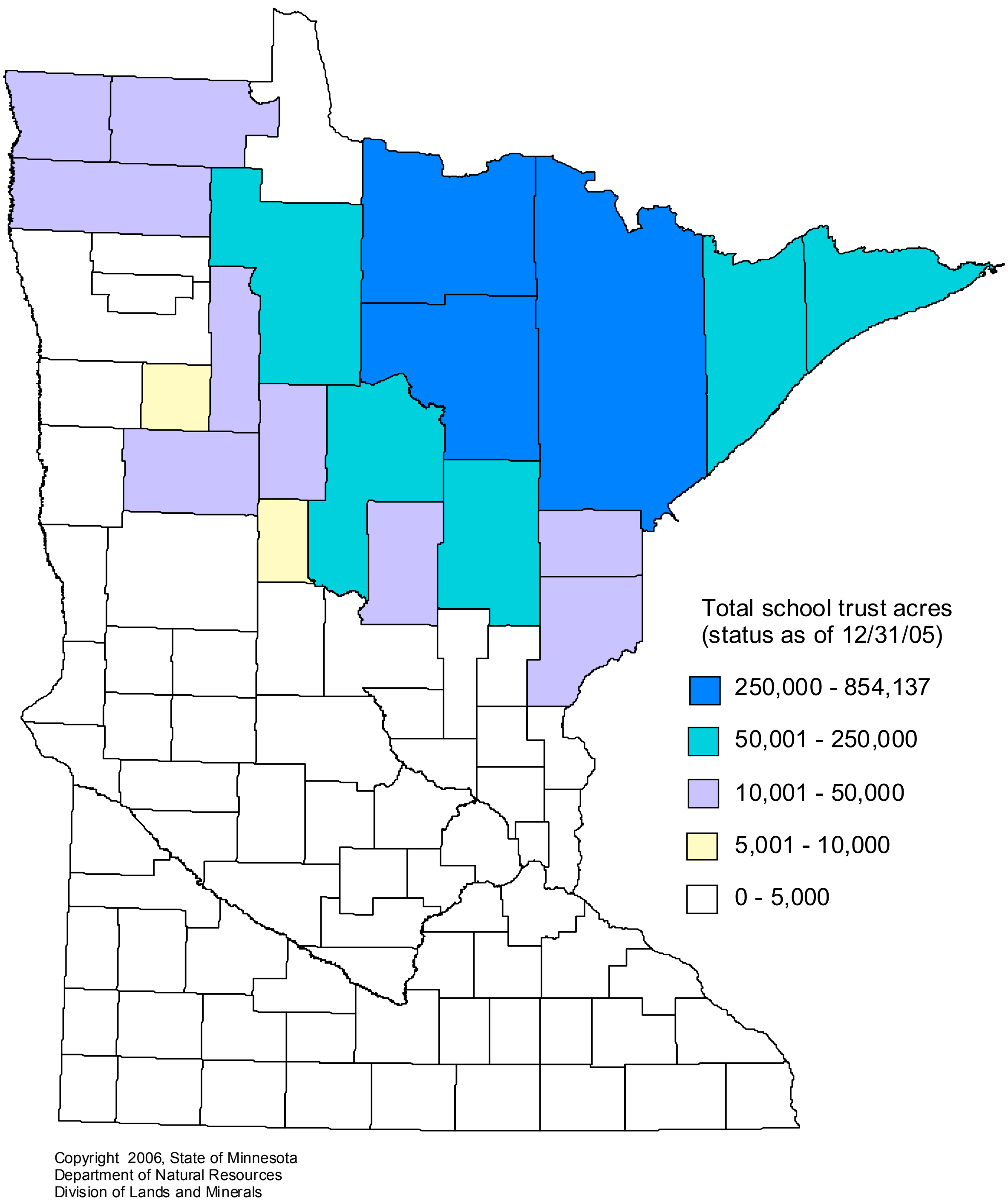


Figure 3. Map of Minnesota's school trust lands, summarized by county.

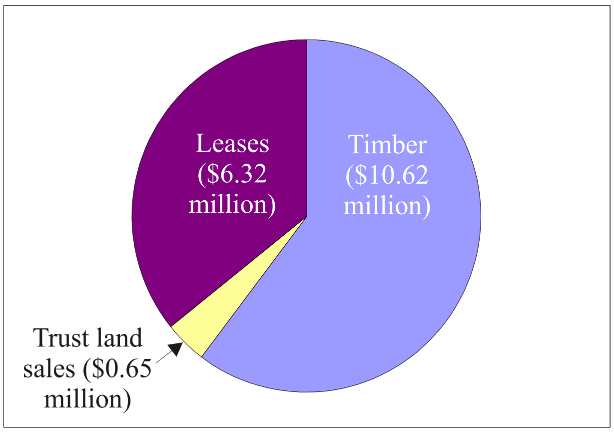


3.1 Total gross revenue.

In **FY04** (7/1/03 - 6/30/04), the gross revenue from activities on school trust lands was about **$17.6 million** (Figure 4).

- Timber sales contributed a total of about $10.62 million.
- Leases accounted for about $6.32 million. Included in this category were mineral leases, which brought in about $5.59 million.
- Sale of trust land totaled about $648,400, including installment payments on land sold in previous years.

FY04 gross: $17.59 million



FY05 gross: $22.30 million

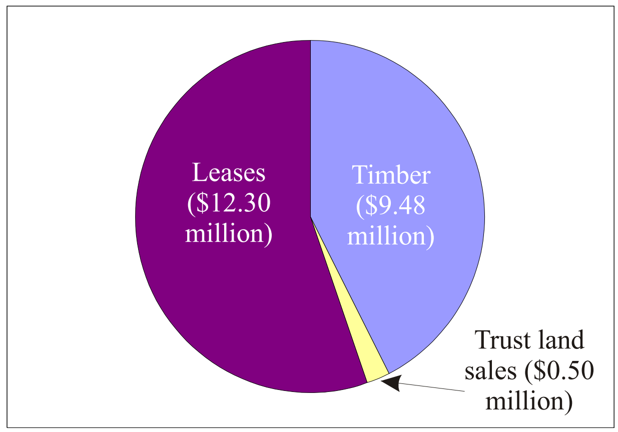


Figure 4. Gross revenue from school trust lands, FY04-05.

In **FY05** (7/1/04-6/30/05), the gross revenue from activities on school trust lands was about **$22.3 million** (Figure 4).

- Timber sales contributed a total of about $9.48 million.
- Leases accounted for about $12.3 million. Included in this were mineral leases, which brought in about $11.56 million.
- Sale of trust land totaled about $505,000, including installment payments on land sold in previous years.

3.2 Total net revenue.

As explained further in section 4, some surface management costs can be certified against certain revenues to determine the net revenue deposited into the PSF. Timber sales and surface lease revenue can be used toward certified costs and is first deposited into the State Forest Suspense Account. For FY06 and FY07, the Legislature has changed the way some mineral management costs will be handled (see section 4). Prior to these changes, management costs could generally not be deducted from revenue derived from mineral activities.

In **FY04** (7/1/03-6/30/04), net revenue to the school trust fund was over **$11.8 million** (Figure 5).

- About $5.59 million came from the Forestry Suspense Account.
- About $5.60 million came from mineral leasing activities, and
- About $0.64 million came from trust land sales.

In **FY05** (7/1/04-6/30/05), net revenue to the school trust fund was over **$16.2 million** (Figure 5).

- About $4.17 million came from the Forestry Suspense Account.
- About $11.57 million came from mineral leasing activities (this is the same as the gross income from minerals because no money was transferred to the general fund during FY03), and
- About $0.50 million came from trust land sales.

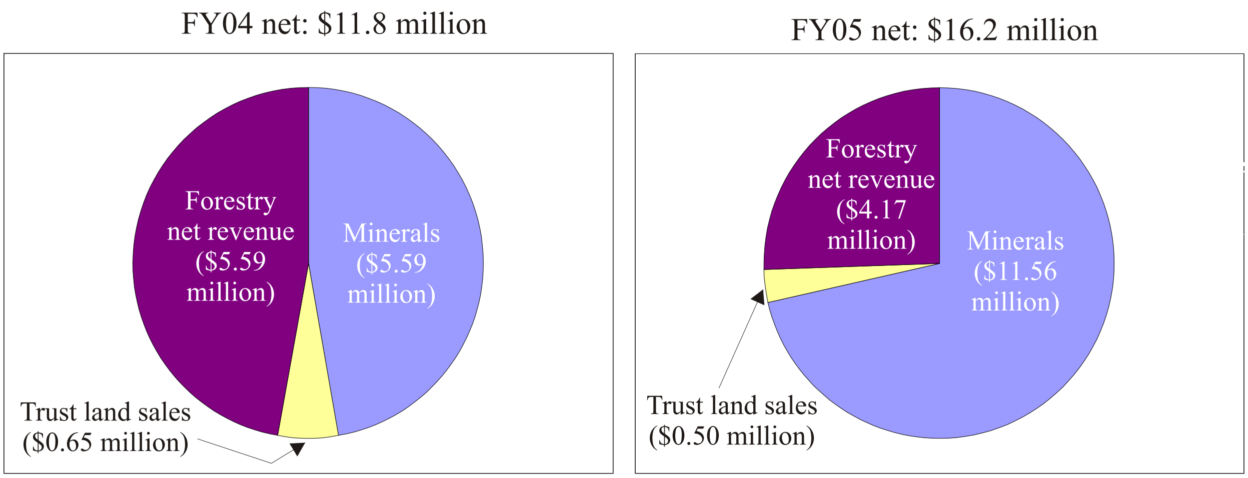


Figure 5. Net revenue to the school trust fund, FY04-05.

3.3 Revenue from minerals activities.

In **FY04**, revenue generated from minerals activities totaled **$5.595 million** (Table 2). The largest contributor to this figure was $5.430 million from taconite iron ore rents and royalties (and interest). Other contributing categories were non-ferrous metallic minerals leases ($81,225), stockpiling/surface leases ($30,625), peat leases ($42,207), and M-leases (leases for stockpiled, low-grade iron materials; $10,800).

Table 2. Revenue from mineral leases, FY04-05.

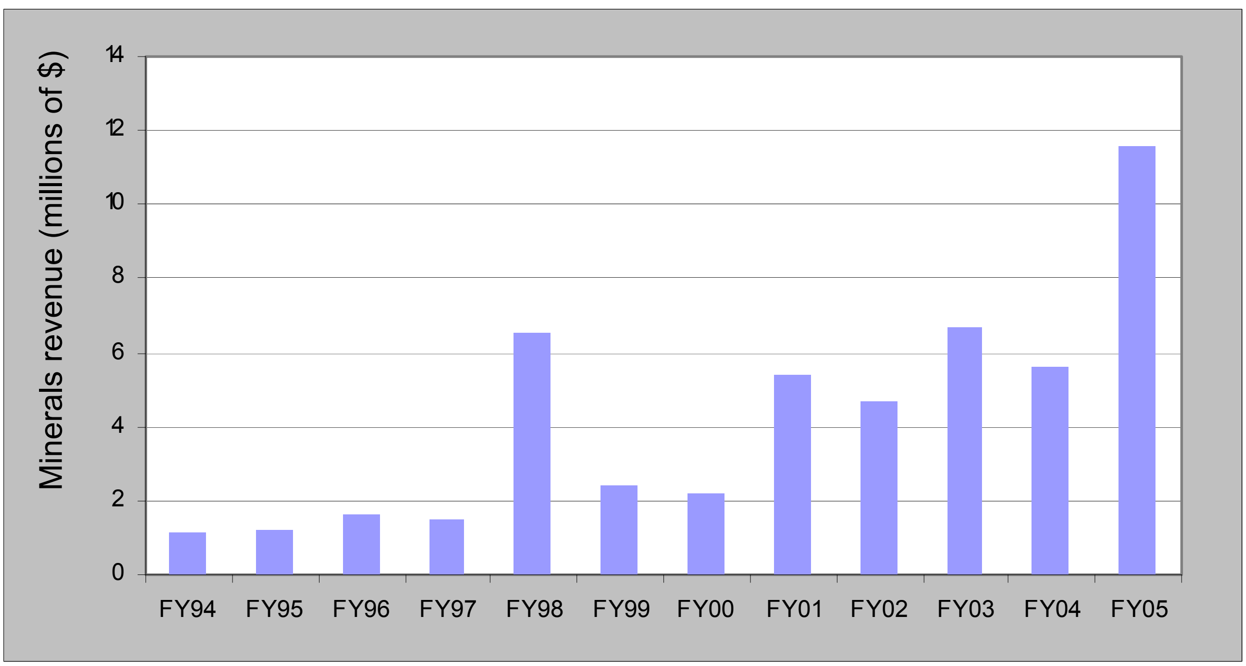
	FY04	FY05
Taconite Iron ore rents/royalties	$5,430,237	$11,334,689
Non-ferrous metallic minerals	$81,225	$82,964
Stockpiling/Surface leases	$30,625	$11,530
Peat	$42,207	$45,490
M-leases	$10,800	$90,112
Total	$5,595,094	$11,564,785

In **FY05**, revenue generated from minerals activities totaled **$11.565 million** (Table 2). The largest contributor to this figure was $11.335 million from taconite iron ore rents and royalties (and interest). Other contributing categories were peat leases ($45,490), non-ferrous metallic minerals leases ($82,964), stockpiling/surface leases ($11,530), and M-leases (leases for stockpiled, low-grade iron materials), which contributed $90,112.

Trends in revenue from mineral leasing

Minnesota's taconite producers suffered a wave of bankruptcies in 2000-2003, but a turnaround that began in late 2003 now has them operating at full capacity. A dramatic increase in steel production and iron ore consumption by China has led to record world wide demand, and school trust revenue from mineral leasing rose almost $6 million from FY04 to FY05.

Figure 6. School trust fund revenue from minerals, FY94-05.



Note: The revenue peak in FY98 (Figure 6) was due to a $4.2 million transfer, in which money was moved from the taconite special advance royalty account to the PSF, following transfer of state leasing agreements between Ontario Iron Co. and USX.

3.4 Revenue from land sales.

In **FY04**, the sale of trust land generated a total of **$648,405** (Table 3). This included installment payments of $440,378 and sale of land payments of $79,439. There were also loan interest payments of $114,778, and land sale service charges of $8,864. When the school trust parcel being sold has marketable timber, the timber value is added to the land value. The timber value for sold trust fund land contributed $4,732. (This is separate from the sales of standing timber. That data is presented in Table 4).

In **FY05**, the sale of trust land generated a total of **$505,253** (Table 3). This included land sale installment payments of $353,234 and sale of land payments of $79,838. There were also loan interest payments of $59,791 and land sale service charges of $9,320. The timber value for sold trust land brought in $3,070.

Table 3. Revenue from land sales, FY04-05.

	FY04	FY05
Sale of land (down payments and paid-in-fulls)	$79,439	$79,838
Sale of land (installment payments)	$440,378	$353,234
Land sale service charge [A]	$8,864	$9,320
Sale of timber [B]	$4,732	$3,070
Loan interest	$114,778	$59,791
Total	$648,405	$505,253

[A] Appraisal fees, legal notices, recording fees, etc.

[B] 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 4.

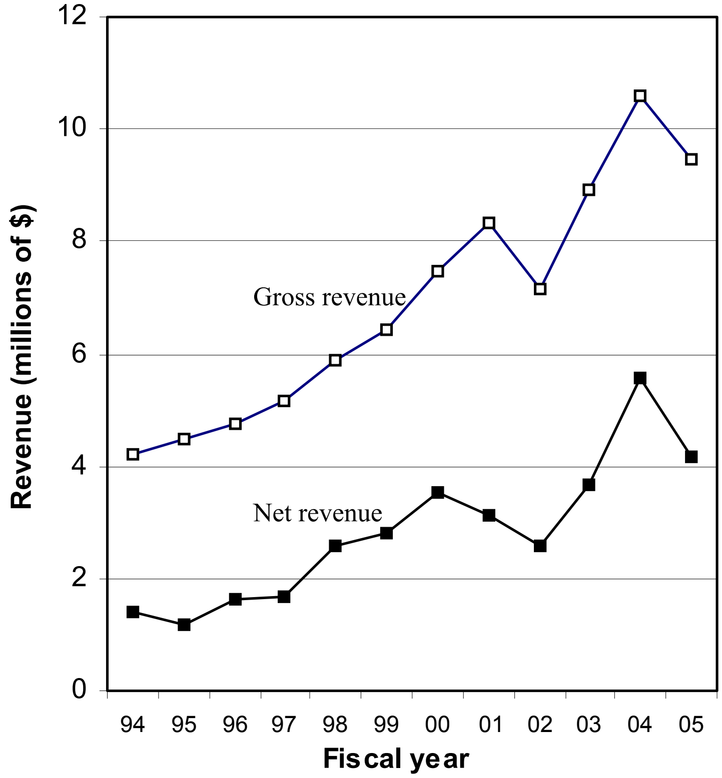
3.5 Revenue from timber sales and surface leasing activities.

3.5.1 Timber sales.

In FY04 and FY05, timber revenues included timber sales and timber sales interest.

1. In FY04, timber sales receipts totaled over $10.6 million, with timber sale interest bringing in about $14,400. All of this revenue was deposited into the Forestry Suspense Account, for certification at the end of the year (Figure 7, Table 4).

2. In FY05, timber sale receipts totaled more than $9.4 million, with timber sale interest bringing in about $5,600. All of this revenue was deposited into the Forestry Suspense Account (Figure 7, Table 4).



Trends in revenue from timber sales

Gross and net revenues from timber sales have trended upward due to increased harvests on school trust lands and substantial increases in stumpage prices.

Net revenue in FY04 was 53% of gross revenue, and the FY05 net was 44% of the gross. Only once in the last ten years has this value been greater (in FY00, when the net was 48% of gross revenue).

Section 4 details which costs can be certified against gross income from state lands.

Figure 7. School trust fund income from timber sales, FY94-05.

Table 4. Revenue from timber sales and surface leasing activities, FY04-05.

	FY04	FY05
Timber sales	$10,603,425	$9,464,879
Timber sales interest	$14,386	$5,582
Sale of standing timber [A]	$5,155	$8,350
Subtotal; timber sales:	$10,622,966	$9,478,811
Leases, licenses, easements [B]	$726,218	$733,533
Campground fees	$143,067	$111,767
Subtotal; surface leasing:	$869,285	$845,300
Total:	$11,492,251	$10,324,111

[A] This is for removal of timber in path of utility line installation, and is distinct from sales of timber on lands sold, which is presented in Table 3. Standing timber revenue is deposited directly into the PSF, and is not subject to certification (see section 4).

[B] See Table 5 for details.

Note: totals may not add due to independent rounding.

3.5.2 Campground fees.

Campground fees from school trust lands totaled $143,067 in FY04, and $111,767 in FY05 (Table 4.)

3.5.3 Surface leases, licences and easements.

In **FY04**, a gross total of about **$726,000** was collected on 3,831 active surface contracts that included some portion of trust land (Tables 4, 5, 6). This included:

Leases:	Aggregates; agriculture; hunting cabins; miscellaneous (commercial, government and private); lakeshore[10]
Permits:	Resource Management Access (RMA)
Easements:	Permanent and temporary easements (primarily road) on trust fund land
Licenses:	Water crossings and land crossings by utilities

Because many of the agreements involve a one-time payment in the year of issue, only some of the active contracts generated revenue in FY04.

In **FY05**, a gross total of about **$734,000** was collected on 4,039 active contracts that included some portion of trust land (Tables 4, 5, 6). As was the case in FY04, many of the active agreements generated revenue only in their year of issue. The contracts that did generate revenue brought in a total of about $733,500.

Table 5. Revenue by contract type, FY04-05.

Contract type	FY04	FY05
Easements	$74,639	$48,303
Land crossings	$11,826	$5,622
Water crossings	$88,568	$105,867
Leases: aggregate	$158,804	$283,817
Leases: agricultural	$11,996	$26,057
Leases: miscellaneous	$356,520	$240,487
Leases: other (boathouse, lakeshore, etc.)	$5,080	$4,939
Leases: hunting cabins	$14,220	$14,700
Wild rice farming [A]	$4,326	$3,470
Late fees on DNR land leases [A]	$239	$271
Total	**$726,218**	**$733,533**

[A] Deposited directly into the PSF; not subject to certification (see Section 4).
Note: Totals may not add up due to independent rounding. Data from MAPS.

Trends in revenue from surface leases, licenses and easements

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

[10] Due to the sale and exchange of state-owned lakeshore parcels, the number of lakeshore leases declined dramatically between FY01 and FY02. As of this writing, only three lakeshore leases remain in effect; the terms of these leases are for the lifetime of the lessee.

Table 6. Approximate number and acreage of active contracts involving school trust land, FY04-05.

Contract type	FY04 (as of 6/30/04)		FY05 (as of 6/30/05)	
	Number of contracts	Acres	Number of contracts	Acres
Agriculture	59	2880	58	2640
Aggregate	37	580	42	630
Home site	6	3	6	3
Hunting cabin	51	28	51	28
Lakeshore cabin	3	3	3	3
Misc. commercial leases [A]	57	847	53	824
Misc. government leases [A]	33	792	32	790
Misc. private leases [A]	94	441	84	194
Misc. leases, combined [A]	64	271	100	535
Easements	701	4949	719	5016
Land crossings	468	11,685	479	11,693
Water crossings	2,150	na	2252	na
Subtotal:	3,723	22,479	3879	22,356
Grant-in-Aid permits	70	na	95	na
Management access perrmits	38	na	65	na
Subtotal:	108	na	160	na
Total:	3,831	22,479	4,039	22,356

[A] Starting 7/1/02, misc. commercial, government and private leases (document types 011, 015, 016, respectively) were combined into a single category (Misc. Leases, document type 012). The old lease numbers will stay in effect until they expire, and if they are renewed, will be given a new (012) lease number.

4. Management costs of school lands.

4.1 Forestry trust land cost certification process.

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

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

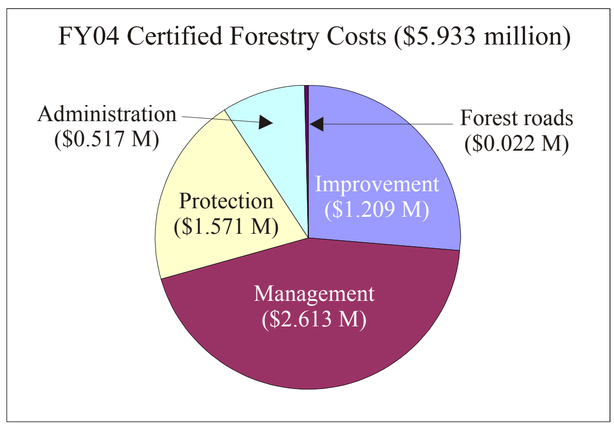
Minnesota Statutes, sec.16A.125 controls which surface management costs can be certified against revenues from trust fund lands, and how the certified costs and net revenues from the trust fund lands are distributed.

The allowable costs are for the protection, improvement, administration and management of forest lands, and for the construction and maintenance of forest roads (Figure 8).

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

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

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



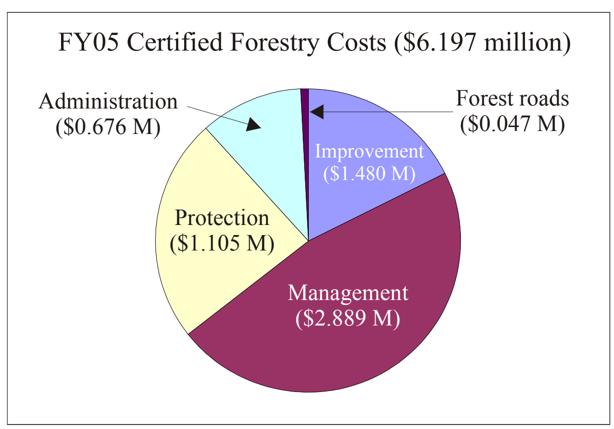


Figure 8. Certified Forestry costs, FY04-05.

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

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

1. **Annual fire protection** (pre-suppression and suppression) costs are spread across all 22.8 million acres of public and private lands receiving our protection services. The resulting per acre charge, similar to a municipal tax levy for fire services, is then applied to the acres of trust fund lands that qualify for cost certification.

2. **Forest road costs** are allocated on a per acre basis to all lands within one-quarter mile of the centerline of the 2,200 mile state forest road system. The cost per acre is then multiplied by the trust land acres within that zone, and that cost total is certified against the trust.

3. **Timber Sales costs** are allocated to all lands in proportion to the revenues received from those lands. For example, 51% of all FY04 state timber sales revenues were from PSF lands, so 51% of all state timber sales costs were attributed to the PSF lands. In FY05, 45% of all state timber sales costs were attributed to the PSF lands.

4. **Forestry administrative costs** (e.g. bill paying, payroll processing, clerical support services, fleet management charges) are prorated in a step-wise fashion based on dollars expended. The first step prorates those costs to each fund from which forestry expenditures are made. The second step prorates the General Fund's share of those administrative costs to the various cost activities on each class of land. Finally, only the portion of those administrative costs that apply to trust fund land activities are certified against trust fund revenues.

Gross revenues received through management of trust lands for forestry (see Table 4) are deposited in the State Forest Suspense Account. (Only revenues derived from forestry activities are included in the process. Non-forestry revenues, such as mineral royalties, are excluded from the process.) Certified costs of management are deducted from the gross, and the net is deposited into the PSF after the close of each fiscal year.

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

4.2 Changes to mineral management costs on school lands.

Beginning in FY06, a portion of DNR's mineral management costs will be paid from school trust mineral income. In an effort to help resolve Minnesota's recent budget deficit, the DNR proposed, the 2005 legislature modified, and the Governor signed a budget that for the first time in the state's history directed a portion of the income earned from the leasing of school trust minerals to the DNR to pay costs related directly to income generation activities conducted by the DNR. A new account called the Minerals Management Account was created to pay for management activities such as mineral lease negotiations, development and management of the school trust leases, and inspection and surveying costs needed to verify the amount of minerals mined. Management costs that result from non-income generating activities such as reclamation, and environmental protection will continue to be funded by the state's general fund and not involve additional PSF income.

There is precedent in the state constitution allowing the use of a portion of the income generated from school trust lands to be used for timber management purposes. An Attorney General's advisory concludes that this directive could reasonably be extended to mineral management as well.

The funding for mineral management will work as follows. Initially, 20% of the income generated from the mining of school and other state-owned minerals (University, Tax-Forfeited, and other state ownership interests managed by the DNR) will be directed to the new DNR Minerals Management Account. The remaining 80% will continue to be directed to the individual trusts. Because it is anticipated that 20% of the overall mineral income will exceed the actual management costs over the first two or three years of the account's life, the account will generate an excess amount of cash. The account was intentionally designed to create a $3 million principal that can be drawn upon in the event future income generation drops. Once the $3 million level is reached, the PSF and Permanent University Fund contributions will drop to lower levels and only return to 20% if the principal in the account dips below $3 million.

In addition to the mineral management activities related strictly to revenue generation (mentioned above), the DNR has sought and received additional funding in the past that was used to improve the likelihood that state-owned minerals would be mined. The expenditure of a relatively small amount of money has in a number of cases led to the lowering of mining costs and has substantially increased the volume of ore that could be mined. The DNR believes that continuation of such activities is important, and will be using a portion of the Minerals Management Account to do such things as: conducting geologic analysis of rock and mineral samples to identify ores that may be mineable; conducting title research on trust lands in order to make these available for future mineral leasing; and conducting studies and research to resolve environmental problems that would make mining of certain minerals viable, or more profitable, and thus more likely to be mined.

5. Review of FY04-05 projects and preview of FY06-07 projects.

5.1 Forestry projects.

In recent years the DNR has been investing in reforestation to enhance the ability of school trust lands to produce more high quality marketable timber. These efforts are aimed at increasing revenue to the PSF. The reforestation efforts initiated today will result in both increased harvests and revenues as the trees reach a merchantable size.

In FY04, 816,000 cords of timber were offered for sale. This offering was up significantly (17%) from the prior year. Public stumpage prices for this wood increased by 16 percent over the prior year. In FY05 the offering was down slightly, to 794,800 cords, but prices were up substantially (50% or more) by the end of the fiscal year. Timber sale offerings in FY06 will increase to 806,600 cords.

Timber management activities such as regeneration and intermediate stand treatments were up in FY04 and FY05. Seedling planting, primarily conifers, grew 23% in FY04 and another 7% in FY05. This is in large part a response to statutory requirements to regenerate harvested land. This trend will likely continue in the next biennium, budgets permitting.

It should be noted that the above statistics refer to all state lands, regardless of their trust status. The PSF lands normally account for between 40 and 60 percent of the total forestry activity in any given year.

5.2 Minerals projects.

5.2.1 Ferrous.

During the FY02-FY03 biennium, several steel and taconite companies were in bankruptcy or for sale, and the future of taconite mining in Minnesota was uncertain. Although Minnesota's taconite companies were working hard at cost reduction, workforce reduction, improved recovery and improved productivity, the news in Minnesota was generally of mine closings and production curtailments.

But after a wave of bankruptcies in the steel and iron ore industry in the past two bienniums, a turnaround that began in late 2003 has Minnesota's taconite producers once again operating at capacity. China's dramatic increase in steel production and iron ore consumption has led to record world iron ore demand and record profits for world iron ore producers.

Sixty-one of the 95 state taconite leases in effect cover school lands. Since 2001, the Department has recommended and the State Executive Council has approved the issuance of three short term royalty reduction amendments to the state taconite leases to aid in the survival of the taconite industry.

On March 7, 2001, the State Executive Council approved the issuance of the first royalty rate reduction amendment to all state taconite leases, which was for the period of April 1, 2001 through March 31, 2002. The amendment created a 15% reduction in the royalty rate as calculated under the state lease agreements for the period of April 1, 2001 through March 31, 2002. The second royalty reduction agreement for the state taconite leases was for the period of January 1, 2002 through June 30, 2003. It provided for a base royalty rate of $0.395 per ton of crude taconite. The third royalty reduction agreement for the state taconite leases was approved by the State Executive Council in March of 2003. It provides for a base royalty rate varying from $0.40 to $0.375 per ton of crude taconite ore for the period of July 1, 2003 through June 30, 2006. The rate is based upon total production each quarter from all the state lands held under lease by each company. The rates are subject to escalation each quarter. During the FY04-05 biennium, rates have ranged from $0.375 to $0.51 per ton of taconite ore.

5.2.2 Non-ferrous.

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

During the FY04-05 biennium, a total of 101 metallic mineral leases were issued, of which 37 were awarded to bidders at the 2004 Metallic Minerals Lease Sale auction, 11 were negotiated leases, and 53 were preference rights leases. These 101 leases were awarded to four companies (Kennecott Exploration Co., Lehmann Exploration Management, Inc., Encampment Resources LLC, and 608457 B.C. Ltd.) and covered a total of 30,735 acres. Four of the leases (covering 1,704 acres) were in Itasca County, 20 (7,836 acres) were in Kanabec County, 22 (7,328 acres) were in Mille Lacs County, and five (covering 13,866 acres) were in St. louis County. Of the 30,735 acres covered by the 101 new leases, 6,851.39 acres (22.3% of the total) is school trust land.

5.3 Land sales.

FY04: In October 2003, the State offered seven parcels of land for sale at public auction, five of which were school trust lands. All five of the trust parcels sold, with a total land value of $106,680. (This amount differs from that shown in Table 3 because some of these sales weren't paid in full till FY05.)

FY05: In August 2004, the State offered five parcels of land for sale at public auction, four of which were school trust lands. In November 2004, the State offered eight parcels for sale at public auction, four of which were school trust lands. In June 2005, the State offered three parcels of land for sale at public auction, two of which were school trust lands. The total land value of the ten school land parcels was $709,741, and all ten parcels were sold. (This amount differs from that shown in Table 3 because some of these sales weren't paid in full till FY06.)

FY06 & FY07: The Department held a public land auction in October 2005 at which four school trust parcels were sold for a total of $35,630, and additional auctions are planned for July 2006 and October 2006, at which both school trust land and acquired land will be offered.

5.4 Land exchange projects involving school trust lands.

The DNR is currently working on two exchanges involving school lands in state parks where revenue generation conflicts with state park management. These school lands are being exchanged for DNR acquired forest land. The purpose of the exchange is to remove the trust status from the land in the state parks and transfer it to forest property that has more potential to generate income for the Permanent School Fund.

The first exchange involves 60 acres of school land in Tettegouche State Park. This land is being exchanged for approximately 60 acres of equally valued DNR forest land located in Lake County. The second exchange involves 3,050 acres of school land in Savanna Portage State Park. This land is being exchanged for approximately 3,000 acres of equally valued forest land located in Carlton County.

The feasibility of two additional exchanges is currently being considered. One exchange would involve the remaining 1,000 acres of school land in Itasca State Park. The second exchange would address approximately 4,500 acres of school land located in the Sand Lake Peatland Scientific and Natural Area in Lake County. The DNR administers a substantial amount of forest land in Cass County, some of which may be used for these two exchanges. These forest lands are currently being analyzed to determine their income generation potential if they were to receive school land status.

There remains approximately 5,702 acres of school land in eight state parks and recreation areas. Completion of the Tettegouche and Savanna Portage State Park exchanges will remove 3,110 from this amount. The Trust Fund classification will be transferred to other DNR administered lands that are better able to generate income for the PSF. None of these exchanges will result in the disposal of any state land. Only the classifications of the lands involved will be changed.

There are other efforts to remove school trust lands from state parks. The DNR lands sale legislation for 2006 would delete 79 acres of school trust lands from the boundary of Schoolcraft State Park. The DNR capital bonding bill includes $1 million to condemn some of the 461 acres of school lands located within Nerstrand Big Woods State Park, with the funding estimated to cover about a third of the land.

When all the school trust lands have been moved out of Tettegouche, Savanna Portage, Itasca, Schoolcraft, and Nerstrand state parks, there will be 663 acres of school lands remaining in Hill Annex State Park, 92 acres in the Cuyuna County Recreation Area and 337 acres in Garden Island Recreation Area. No action is planned to remove school lands from the Hill Annex State Park as the lands are generating revenue from a real estate lease and from mineral leases to Minnesota Steel Industries; also, a taconite resource remains in this park and mining is an authorized activity in this park. There are no plans to remove the school lands from the Cuyuna

Country Recreation Area as mining is authorized within the recreation area, and because it has the potential for earning revenue. Future plans for Garden Island Recreation Area have not been made.

5.5 Legislative changes during FY04-05.

During 2004 significant changes in how the DNR must manage school trust lands were passed into law. Amendments were made to Minnesota Statutes, sec. 92.121 requiring the evaluation of school lands located within certain key resource management areas to determine if the goals for school trust lands (contained in Minnesota Statutes, sec. 127A.31) were being met. In essence the change in law, which clarifies earlier more generally worded constitutional and statutory policies, now requires the DNR to modify its management practices when those practices diminish or prohibit revenue generation. In the event the DNR determines that such changes are impractical or undesirable, the law alternatively requires that the school lands be exchanged for other lands from which income can be generated.

Also during 2004, the Legislature and Governor enacted a resolution memorializing Minnesota's Congressional Delegation to authorize that an increase in the existing Boundary Waters Canoe Area Wilderness (BWCAW) reservation fee be allocated to Minnesota's Permanent School Fund. This would have resulted in a portion of the fees, charged to BWCAW visitors, being used to compensate the PSF for use of school trust lands located in the BWCAW.

The recommendation of the Legislature and Governor has yet to be acted upon. Because of inaction at the federal level involving this initiative and earlier requests by the DNR to exchange school trust lands within the BWCAW for federal lands outside the BWCAW (see discussion in the FY02-03 Permanent School Fund Report), there is still no resolution to the 87,000 acres of school trust land located within the BWCAW that is not generating income for the PSF.

5.6 Aggregate inventory project.

The DNR received $100,000 for the FY06-07 biennium to enhance revenue generation from the sale of construction aggregates on school trust lands. Laws of 2005, First Special Session, Chapter 1, Article 2, Section 3, subdivision 2 appropriates $50,000 the first year and $50,000 the second year from the state forest suspense account in the permanent school fund to identify, evaluate, and lease construction aggregate located on school trusts lands. The DNR's Division of Forestry has also provided significant contributions to this project, through direct funding support in FY05 and through staff support of site administrators.

Projects undertaken so far include:

- As existing leases come up for renewal, DNR updates the price rate structure for various products and the reclamation conditions. Also, the lease term is usually reduced to 3 years vs. 10 years.
- One resource site evaluation has been completed to plan for a new pit.

- One additional site is in the process of being offered for lease in 2006.
- During the summer of 2006, two additional resource evaluations and management plans will be done at new sites for the purpose of future gravel lease sales.
- Future lease sales that target Mn/DOT highway projects are being marketed through a cooperative project with Mn/DOT. These will involve existing pits.

- Resource evaluations will be done at two additional parcels (greenfields) for the purpose of comparison of future gravel lease sale vs. direct parcel sale.
- Lab tests will be performed as the first step to evaluate bedrock outcrops at prospective future crushed stone quarry sites in areas of gravel scarcity.

5.7 Trust fund revenue enhancement project.

The DNR received $300,000 for the FY06-07 biennium to enhance revenue generation from certain real estate related activities on school trust lands. Laws of 2005, First Special Session, Chapter 1, Article 2, Section 3, subdivision 2 provides for: $150,000 the first year and $150,000 the second year from the state forest suspense account in the permanent school fund to accelerate land exchanges, land sales, and commercial leasing of school trust lands.

This appropriation is to be used toward meeting the provisions of Minnesota Statutes, section 92.121, to exchange school trust lands or put alternatives in effect when management practices have diminished or prohibited revenue generation, and the direction of Minnesota Statutes, section 127A.31, to secure maximum long-term economic return from the school trust lands consistent with fiduciary responsibilities and sound natural resources conservation and management principles.

Projects undertaken so far include the land exchanges and legislation described in section 5.4, as well as the following activities regarding land sales:

- Fourteen parcels, totaling 483 acres, of school trust lands have been identified for sale in July of 2006. Revenue projections are in the range of $400,000 to $500,000.
- DNR's Land Sale/Boundary legislation for 2006 seeks authorization to sell another trust parcel, totaling 51 acres, that contains a small public watercourse.
- Twelve additional parcels have been identified for possible sale, but will need further evaluation or resolution of land use issues prior to offering.
- DNR is working on identifying further sale parcels for October of 2006 and the spring of 2007.

The trust fund revenue enhancement project will also inventory two pilot areas. The Pine County pilot area includes a broad mixture of DNR management units, including state forests, a state park, and wildlife management areas. The St. Louis County pilot area has a higher concentration of trust fund lands than the Pine County area, but fewer varied management units. Both pilot projects include transportation corridors.

The data that will be gathered to analyze the lands and minerals will include timber productivity, mineral and gravel potential, natural heritage features, wetland characteristics, known cultural resources, and water frontage. DNR will also review the income that has been generated from these lands and any future projections of revenue.

After the data is gathered, there will be an analysis of what else, if anything, DNR could be doing to manage the land differently for long-term maximization of revenue under sound natural resource conservation and management principles. Management opportunities could include: timber or mineral development; leasing the land for commercial or agricultural activities; or promoting recreational activities that can be done in a manner that economically benefits the trust. In some instances the trust lands may only provide benefits that do not easily translate into an economic return to the trust. In those instances, the analysis may result in a recommendation to exchange the trust land for other lands that can provide on-going long term income to the trust; or, if that is not practical, to sell the trust land and invest the one-time earnings that are received.

Finally, the project is conducting the following studies:

- Commercial leasing opportunities The initial focus of work has been on leasing programs of other states, and wind power opportunities.
- Broad characteristics of all school trust lands Maps and background information are being prepared on the school lands, including wetland characteristics, management units (e.g., forests, parks, SNAs, etc.), DNR administrators, known mineral resources, and proximity to transportation corridors.

6. Management of the PSF and income payments to public schools. [12]

The State Board of Investment (SBI) is the agency that manages the PSF. Income earned from the school trust lands is added to the PSF principal, which is then invested by the SBI. In accordance with the Minnesota Constitution, the principal of the PSF cannot be spent, and instead must remain perpetual and inviolate. Each year the SBI distributes interest and dividends earned from investment of the PSF to the public schools. This is accomplished by using the PSF income to offset the State's general fund education appropriation.[13]

About $16 million of spendable income was generated by the PSF fund in FY04 and distributed to the public schools (i.e. less than 1% of the total school aid amount appropriated by the legislature). In FY05, payments to schools totaled about $19 million. As of June 30, 2003 (the beginning of the FY04-05 biennium) the market value of the PSF was $527 million, the majority of which was generated from land and timber sales, land leases, and mineral taxes and royalties collected since the time of statehood. Reflecting the general growth in the stock market over the FY04-05 time period, the market value of the PSF principal rose from $527 million to $578 million during FY04, and had increased to $612 million by the end of FY05.

[12] Data provided by the State Board of Investment
[13] Office of the Legislative Auditor, p.101

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