Minnesota's School Trust Lands

Biennial Report for Fiscal Years 2000-2001

(July 1, 1999 to June 30, 2001)

Minnesota Department of Natural Resources
February 2002

Message from the DNR Commissioner

Our children and our natural resources are two of Minnesota's most important treasures. Children and natural resources are connected in many ways in our state. 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 dollars for education since 1862 through land and timber sales, leases, and mining royalties. The proceeds are deposited in the Permanent School Fund, which invests the money and supports the annual budgets of each school district in the state. This funding is a relatively small but 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, generally, 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 Permanent School Fund 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 Permanent School Fund. The leadership and staff of each of these entities take that responsibility seriously.

In 1998 the Legislative Auditor recommended that the DNR prepare a biennial report on how the school trust land was being managed. This is the first of those reports. I hope you'll take the time to read it and learn more about how these lands and minerals benefit Minnesota's children.

Al Garber

Minnesota's School Trust Lands Biennial Report for FY00-01

Figures and Tables

I. 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 further 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 became 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, from Ohio in 1802 through Alaska in 1959, 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] Article 11, Section 8 of the Minnesota Constitution established the Permanent School Fund (PSF) and the State Board of Investment. 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. [6] A State Land Office was established in 1863 to manage the trust lands. 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.

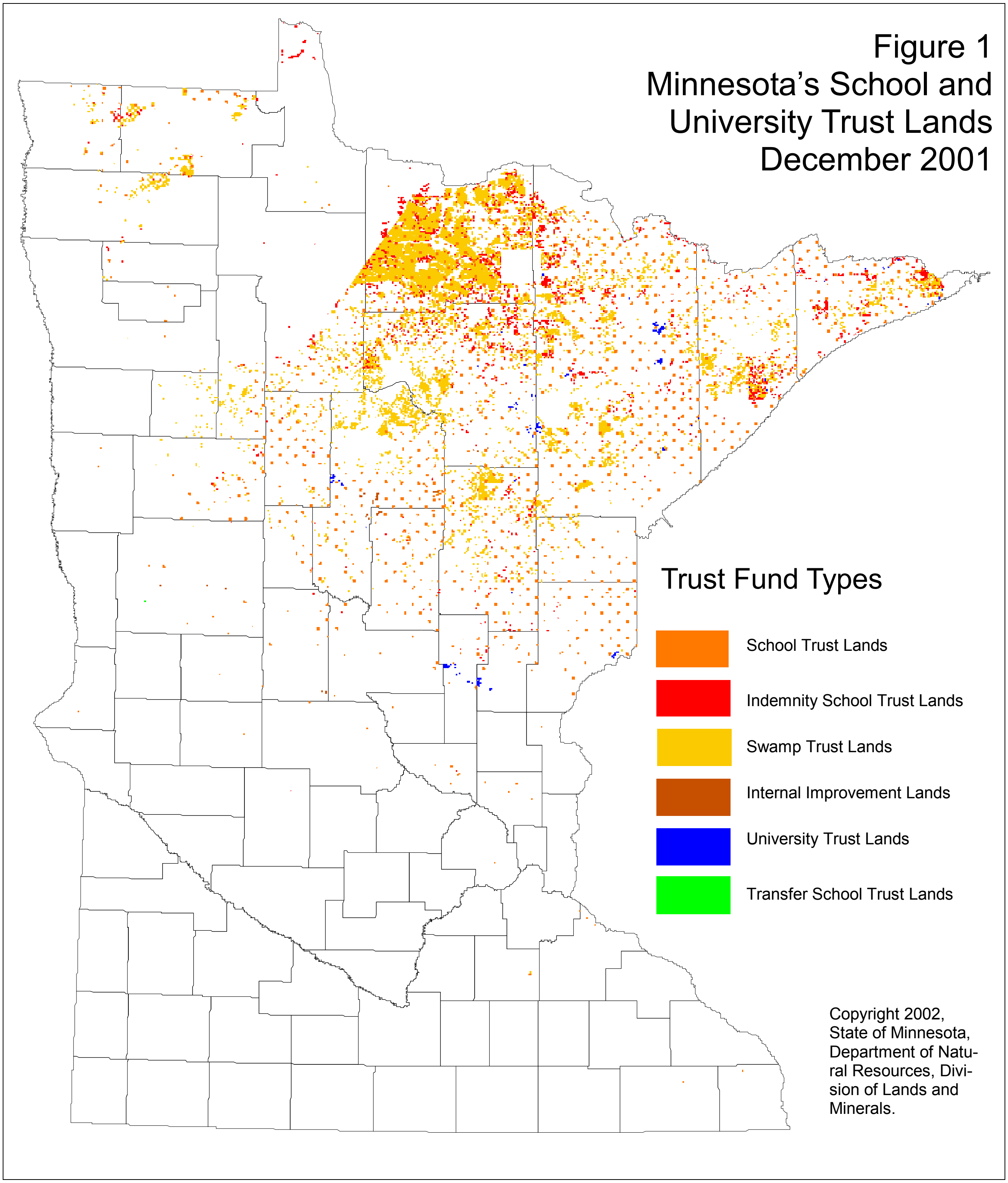
Minnesota, like many other states, sought to translate trust land into cash for the schools; the first sale of Minnesota school trust land took place in 1862. By 1900 much of the best agricultural, timber, and mineral lands–especially in the southern part of the state – had been sold to private interests, with mixed results for the schools. [7]

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. [8]

[1] Matthias Nordberg Orfield, *Federal Land Grants to the States with Special Reference to Minnesota.* (Minneapolis, University of Minnesota, 1915) pp. 7-13.
[2] Ibid. p. 37.
[3] Minnesota Legislature, Office of the Legislative Auditor, *School Trust Land, A Program Evaluation Report* (St. Paul, 1998), p. 3; Orfield, pp. 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] Office of the Legislative Auditor, p. 15.
[7] Minnesota Department of Natural Resources, *School Trust Land Management Report,* (St. Paul, 1983), pp. 10-12.
[8] Ibid., pp. 14-15.

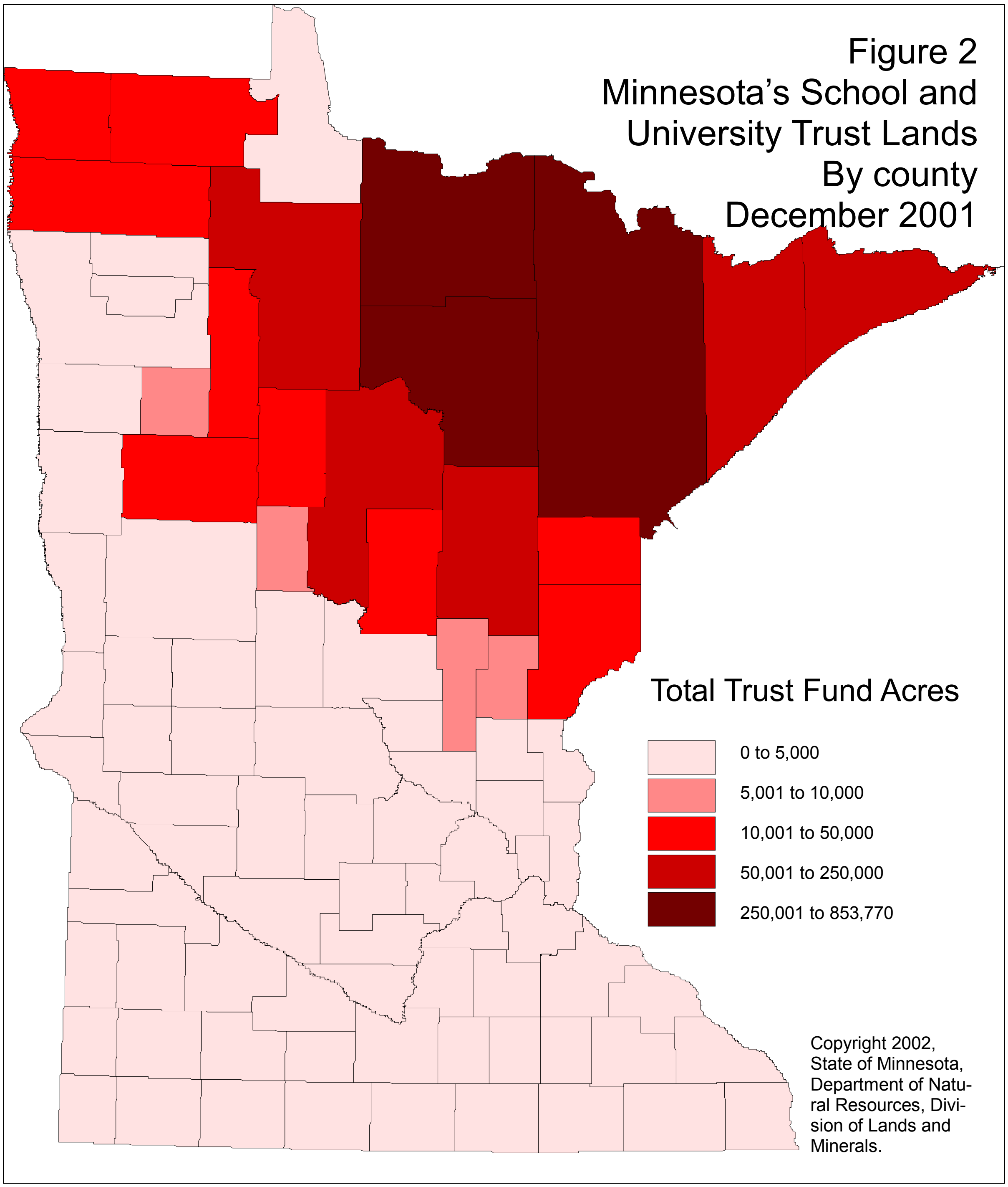
II. Minnesota's Trust Land Today

Minnesota today has approximately 2.5 million acres of land in school trust status, and an additional 1 million acres of severed mineral rights (see Figure 1). This represents the remainder of the original 2.9 million acres of school trust land granted in 1857, including lands granted in lieu of sections 16 and 36 if these were no longer available (Indemnity Lands), as well as other lands that have acquired trust status through transfer. Also included are 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.[9] Most school trust lands are located in the northern part of the state (see Figure 2).

Minnesota's substantial trust land acreage and the corresponding management issues places Minnesota with most western states, that generally still manage significant amounts of land and mineral resources for a variety of trusts. Eastern states have generally already disposed of trust lands permanently. For example, as of 1997 Iowa had no school trust lands, and Wisconsin has less than 5,000 acres. In contrast, the Dakotas each managed over 600,000 acres of school trust land during the same time period.[10]



[9] Ibid., p. 1.
[10] Office of the Legislative Auditor, p. 18.

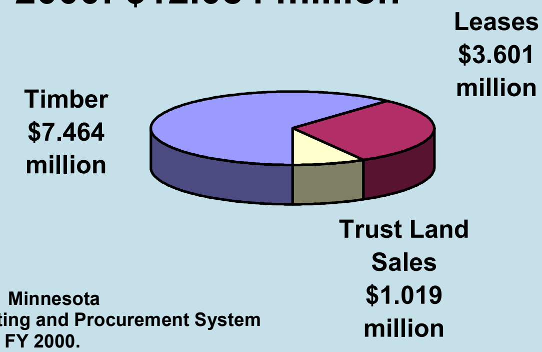
III. Revenues from School Trust Lands, 2000-1

Revenue for the Permanent School Trust Fund is generated from many activities, including sales of timber, wild rice leases, sand and gravel 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 iron removed from trust land, leases to remove peat, non-ferrous metallic mineral leases, and several other types of mineral rights use.

Total Gross Revenues

In Fiscal Year 2000 (July 1, 1999 to June 30, 2000) the gross revenue from activities on school trust lands was over $12 million (see Figure 3).

Figure 3: Gross Revenue from School Trust Land FY 2000: $12.084 million

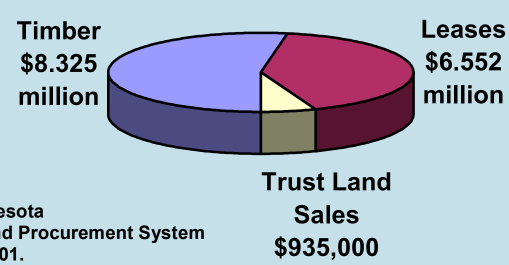


Source: Minnesota Accounting and Procurement System (MAPS), FY 2000.

- Timber sales account for most of the gross revenue, contributing a total of about $7.5 million.
- Leases, including mineral leases, which brought in nearly $2.2 million, and leasing of DNR lands (including campground fees), which earned about $1.4 million, accounted for the next largest category of revenue, totaling over $3.6 million.
- Sale of trust land, including $705,500 in installation payments on land sold in previous years, totaled over $1 million.

In Fiscal Year 2001 (July 1, 2000 to June 30, 2001) the gross revenue from activities on trust fund land was about $15.8 million (see Figure 4).

Figure 4: Gross Revenue from School Trust Land FY2001: $15.8 million



Source: Minnesota Accounting and Procurement System (MAPS), FY 2001.

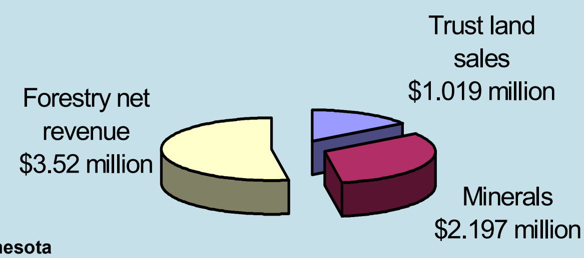
- Timber sales earned the most, contributing about $8.3 million.
- Mineral leases and leasing of trust land brought in about $6.5 million, with minerals contributing $5.4 million and surface land leases (including campground fees) contributing around $1.1 million.
- The sale of trust land contributed a total $935,000, including installation payments from previous sales contributing over $517,000.

Total Net Revenues

As explained further in Section IV, some surface management costs can be certified against certain revenues to determine the net revenue deposited into the Permanent School Fund. Timber sales and most surface lease revenue can be used toward certification costs and is first deposited into the Forestry Suspense Account. Revenue from minerals activities and sales of trust land have not generally been permitted to charge management costs. Starting in FY02, the Legislature has changed the way some mineral management costs are handled (see Section IV.)

In Fiscal Year 2000, the net revenue allocated to the Permanent School Fund was about $6.7 million (see Figure 5). About $3.5 million came from the Forestry Suspense Account, wild rice farming leases, and late charges on DNR land leases; nearly $2.2 million from minerals activities; and over $1.0 million from trust land sales, which includes money from standing timber on sold land.

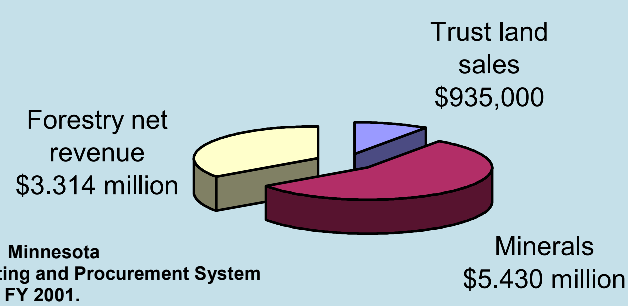
Figure 5
Net Revenue to School Trust Fund
FY2000: $6.7 million



Source: Minnesota Accounting and Procurement System (MAPS), FY 2000.

In Fiscal Year 2001, the net revenue allocated to the Permanent School Fund was about $9.7 million (see Figure 6). This included about $3.3 million from the Forestry Suspense Account, wild rice farming leases, and late charges; $5.4 million from minerals revenues; and $935,000 from trust land sales, including standing timber on sold land.

Figure 6
Net Revenue to School Trust Fund
FY 2001: $9.7 million



Source: Minnesota Accounting and Procurement System (MAPS), FY 2001.

Revenues from Minerals Activities

In Fiscal Year 2000, revenue generated from minerals leases totaled nearly $2.2 million (see Table 1). The largest contributor to this figure was nearly $2.1 million from iron ore rents and royalties. Other contributing categories were peat lease royalties, which approached $34,600; non-ferrous metallic minerals, at $23,200;

Table 1
Revenue from Mineral leases, FY00-01

	FY00	FY01
Industrial Minerals	N/A	$189
Iron Ore Rents and Royalties	$2,100,000	$5,310,000
*M-Leases	$23,200	$12,100
Non-Ferrous Metallic Minerals	$23,200	$46,900
Peat	$34,600	$58,000
Stockpiling/Surface Leases	$16,700	$4,320
Total	**$2,197,000**	**$5,430,000**

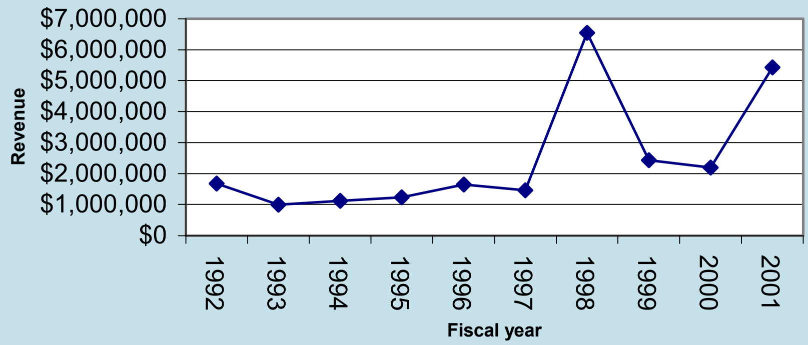
*Low grade stockpiled taconite material.

Source: DNR Division of Lands and Minerals, 2001.

M leases (a stockpiled low grade iron material lease) at nearly $23,200; and stockpiling/surface leases at $16,700.

In Fiscal Year 2001, revenue generated from minerals leases totaled about $5.4 million, a large gain from the previous year (see Table 1). Primary reasons for the increase in minerals revenue included the expiration of leases issued prior to 1951 at a $0.05 rate per ton, plus an increase in mining on state land. The largest contributor to revenue in FY 2001 was iron ore rents and royalties, at over $5.3 million. An increased interest in metallic mineral exploration in the northeastern part of the state resulted in the issuance of more non-ferrous metallic mineral leases, which helped to increase the income from this source during FY 2001 to nearly $46,900. Other contributors included peat lease royalties, at $58,000; M leases at $12,100, and stockpiling/surface leases at $4,320.

Figure 7
School Trust Fund Income from Minerals
Fiscal Years 1992-2001



Trends in Revenue Receipts from Minerals. The peak in revenue from FY 1998 was due to a $4.2 million appropriation transfer, in which money was moved to the Permanent School Fund following transfer of state leasing agreements between Ontario Iron Company and USX. In FY 2001, another sharp increase in revenue occurred because of an increase in mining on state owned lands and the expiration of long term state leases with low rates.
Source: "Revenue Received from State Mineral Leases: Fiscal Years 1890-2001" MN DNR Division of Lands and Minerals.

Revenues from Land Sales

In Fiscal Year 2000, the sale of trust land generated a total of over $1.0 million (see Table 2). This included land sale installment payments of $706,000 and sale of land payments of $56,000. There were also loan interest payments of $210,000 and land sale service charges of $7,760. Sale of timber from sold trust fund land was also included in this group, coming to nearly $39,000.

Table 2
Revenue from Land Sales, FY00-01

	FY00	**FY01**
Sale of Land	$56,000	$204,000
Sale of Land, Installment payments	$706,000	$517,500
Land Sale Service Charge	$7,760	$13,260
*Sale of Standing Timber	$39,000	$10,300
Loan Interest	$210,000	$189,500
Total	**$1,019,000**	**$934,560**

*On sold land. A separate category from sales of standing timber found in Table 3.

Totals may not add due to independent rounding.
Source: Minnesota Accounting and Procurement System (MAPS), FY 2000 and 2001.

In Fiscal Year 2001, the sale of trust land generated a total of over $934,000 (see Table 2). The revenue for FY 2001 for land sales included installation payments of $517,000 and sale of land payments of $204,000. The loan interest payments this fiscal year total about $189,500, with land sale service charges equaling about $13,260. Timber sold from sold trust fund land this year brought in $10,300.

Revenues from Timber Sales and Surface Leasing Activities

Timber Sales

In fiscal years 2000 and 2001, timber revenues included timber sales and timber sales interest, which are collected by Division of Forestry.

For Fiscal Year 2000, sale of timber was almost $7.5 million, with an additional $1,900 from timber sale interest (see Table 3). All of this revenue was deposited in the Forestry Suspense Account.

In Fiscal Year 2001, timber sales receipts totaled over $8.3 million, up 11.4 percent from FY 2000 (see Table 3). Timber sales interest was also much higher, with over $11,200 generated. This money was added to the Forestry Suspense Account for certification at the end of the year.

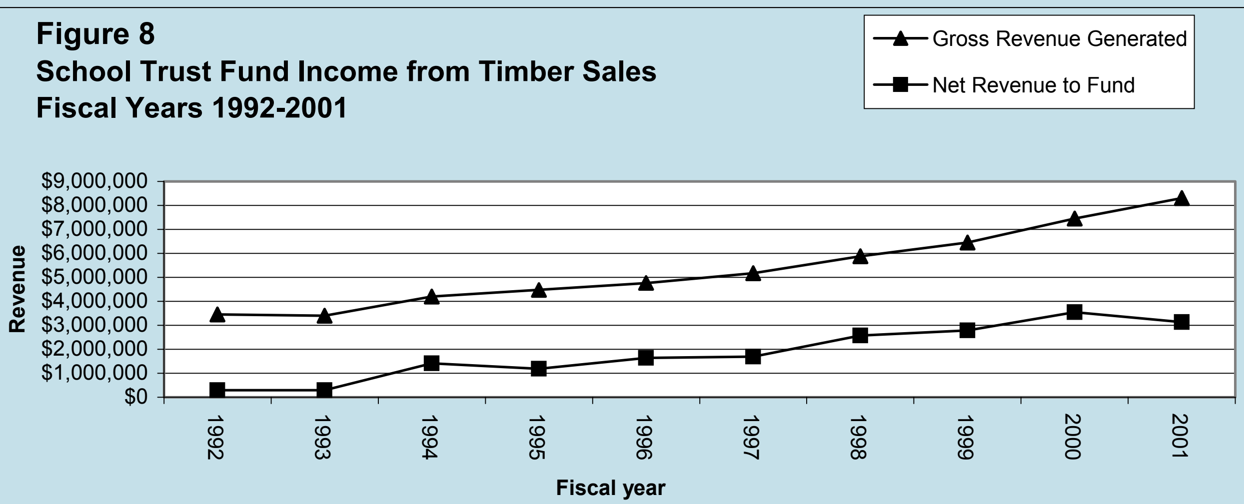
Table 3
Revenue from Division of Forestry Timber Sales and Surface Leasing Activities, FY00-01

	FY00	FY01
Timber Sales	$7,453,590	$8,302,180
Timber Sales Interest	$1,900	$11,200
*Sale of Standing Timber	$8,800	$12,000
Subtotal, Timber Sales	**$7,464,290**	**$8,325,380**
**Contracts	$1,272,660	$975,960
Campground Fees	$136,000	$145,280
Subtotal, Surface Leasing	**$1,408,660**	**$1,121,240**
Total	**$8,872,950**	**$9,446,620**

* For removal of timber in path of utility line installation, distinct from sales of standing timber in Table 2. Deposited directly to Permanent School Fund (PSF). Income not subject to certification (see Section IV).
** Licenses, leases, and easements. See next page for details.

Totals may not add due to independent rounding.
Source: Minnesota Accounting and Procurement System (MAPS), FY 2000 and 2001.

Figure 8
School Trust Fund Income from Timber Sales
Fiscal Years 1992-2001



Trends in Revenues From Timber Sales. Gross and net revenues have trended upward due to increased harvests on school trust lands. The slight decline in net timber sales revenues in 2001 was caused by an increase in certified reforestation costs [required by M.S. 89.002(2)] as a direct result of the increased harvesting activities on trust lands. (Section IV details what costs can be certified against gross income from trust lands.)
Source: M.S. 16A.125 Subd. 5(1) Transfer Certification Report, Fiscal Year 2001, MN DNR Division of Forestry.

Surface Leasing Activities (Contracts [11] and Campground Fees)

In Fiscal Year 2000, a gross total of about $1.4 million was collected on 5,952 active contracts that included some portion of trust land, and campground fees (see Tables 3, 4, and 5). This included almost $1.3 million from leases for sand and gravel, agriculture, hunting cabins, Grant-In-Aid permits, lakeshore leases [12], miscellaneous commercial, government, and private leases, resource management access permits, permanent and temporary easements on trust fund land, water crossings and land crossings licenses. Because many of the agreements involved a one-time payment in the year of issue, only about 830 of the active contracts generated revenue in FY 2000. Campground fees brought in nearly $136,000.

Of the FY 2000 total generated, about $709,000 from contracts and $136,000 from campgrounds went to the Forestry Suspense Account for certification of the Division of Forestry's management costs. (See Section IV for details.)

Table 4
Revenue by Surface Lease Contract Type, FY00-01

	FY00	FY01
Agriculture	$18,000	$15,000
Grant-in-Aid permit	$16,000	$68,700
Gravel	$351,000	$196,000
Home site	$1,300	$1,660
Hunting Cabins	$13,000	$13,000
*Lakeshore (to Lakeshore lease account)	$550,000	$163,000
Lakeshore (to Forestry Suspense Account)	NA	$163,000
Misc. Commercial	$115,000	$108,000
Misc. Government	$34,000	$48,000
Misc. Private	$8,000	$7,000
Resource Management Access (RMA) Permits	$170	$1,300
**Wild Rice Farming	$7,300	$5,800
Easements	$28,000	$64,000
Land Crossings	$12,000	$6,500
Water Crossings	$118,000	$113,000
**Late fees on DNR land leases	$890	$2,000
Total	**$1,272,660**	**$975,960**

*Deposited directly to Lakeshore Lease Account. Income not subject to certification (see Section IV).
** Deposited directly to Permanent School Fund (PSF). Income not subject to certification (see Section IV A).

Totals may not add due to independent rounding.
Source: Minnesota Accounting and Procurement System (MAPS), FY2000 and 2001.

In Fiscal Year 2001, a gross total of about $1.1 million was collected on about 6,378 active leases [13], licenses, and easements that included some portion of trust land (see Tables 3, 4, and 5). As in FY 2000, many of the active agreements involved a one-time payment occurring in the year of issue. Of the 840 contracts that created revenue in FY 2001, gross receipts totaled almost $976,000. Campground fees brought in $145,280.

[11] Leases, licenses, easements. See Table 4.
[12] In FY00, lakeshore leases generated about $550,000. Under *Minn Stat*. § 92.46 subd. 1 (d), 100 percent of this amount in FY00 went into a lakeshore account for use in surveying, appraising, and other costs associated with selling, leasing, or exchanging the lakeshore lots.
[13] A law affecting the lakeshore leases, *Minn. Stat*. § 92.46 subd. 1, (d), changed the way that revenue received from lakeshore leases was allocated in this year. In fiscal year 2001, only 50 percent (down from 100 percent in FY 2000 and FY 1999) of the revenue received from lakeshore leases was deposited in a lakeshore leases and sales account for costs associated with the lakeshore lot exchanges. The other 50 percent was deposited in the Forestry Suspense Account. Given this requirement, the lakeshore lease account and the Forestry Suspense Account each received over $163,000 (including late fees) in FY 2001.

Another source of revenue that contributed money to the Permanent School Fund in FY 2001 were Grant-in-Aid (GIA) permits. In FY 2001, a change of payment procedures went into effect, resulting in a one-time payment for the term of the GIA permits, rather than several annual payments throughout the duration of the permit. A lump sum of over $54,000 was therefore paid to the school trust in FY 2001 to pay off the remaining fees owed on the permits already in effect. In addition, the payment-in-full for permits newly issued in FY 2001 resulted in the transfer of an additional $14,700.

In all, about $804,000 from contracts and $145,280 from campground fees went into the Forestry Suspense Account for certification. (See Section IV for details.)

Table 5
Approximate number and acreage of contracts involving School Trust Land, FY00-01

Contract type	FY00 Number of contracts	Acres	FY01 Number of contracts	Acres
Agriculture	50	2000	69	2900
Gravel	45	700	44	650
Home site	40	25	6	3
Hunting	50	30	53	30
*Lakeshore	540	530	536	400
Misc. Commercial	70	900	74	1450
Misc. Government	60	450	65	1500
Misc. Private	120	300	122	470
Easements****	590	3300	600	3350
Land Crossings****	405	7010	415	7025
**Water Crossings	4500	N/A	4890	N/A
Total** **	**6470**	**15245**	**6874**	**17778**
	Number of contracts	*****Forties**	**Number of contracts**	*****Forties**
Grant-in-Aid	107	1896	120	1953
RMA Permits	70	186	79	196
Total	**177**	**2082**	**199**	**2149**
Grand Total of Contracts******	**6647**		**7073**	

*Due to the sale and exchange of state-owned lakeshore parcels, the number of lakeshore leases in future fiscal years will be greatly reduced. At the time this report was printed, only three lakeshore leases remain. The terms of these leases are for the lifetime of the lessee.
** Water Crossings involve linear areas in lake beds for which acreages are not calculated. All one-time fees collected from water crossings go to the Forestry Suspense Account.
*** Grant-in-Aid and Resource Management Access Permits are calculated only on the number of Public Land Survey forties passed through, not total acres.
**** These numbers revised March 26, 2002 after errors in the easements and land crossings columns were noted in the original. Totals may not add due to independent rounding.
Source: Minnesota DNR Land Information System, Division of Lands and Minerals, 2001.

IV. Management Costs of School Trust Lands

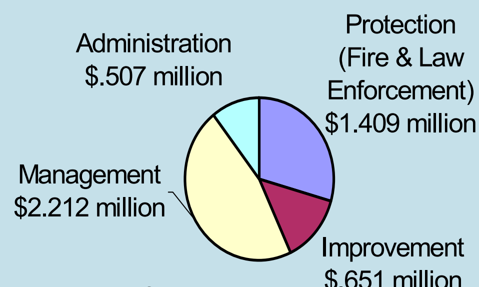
Forestry Trust Land Cost Certification Process

Minnesota Statute 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. Only those charges that were paid from the state's General Fund are included. Costs charged to dedicated funds and federal funds are excluded from the cost certification process. In addition, only revenues derived from Division of Forestry activities are included in the process. Non-forestry revenues, such as mineral royalties, are excluded from the process.

The Division of Forestry identifies hours of paid staff time and dollars expended using a set of cost codes. These cost codes identify charges based on the type of activity (e.g., tree planting, forest inventory, campground maintenance), and on what type of land 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. Identified costs are prorated on a uniform per acre basis between school and university trust lands and certified accordingly. 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.

Figure 9
Certified Forestry Costs (by type)
FY2000: $4.779 million

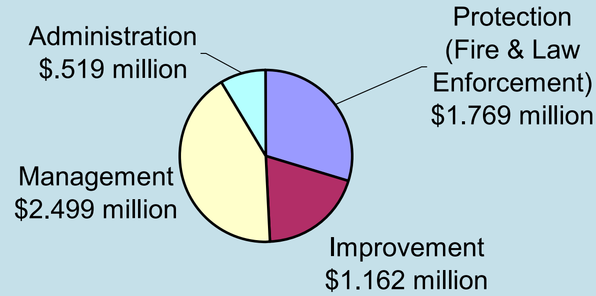


Source: DNR Division of Forestry

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

- Annual fire protection (pre-suppression and suppression) costs are spread across all 22.8 million acres of public and private lands receiving 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.
- 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 times the trust land acres within that zone, and that cost total is certified against the trust.

Figure 10
Certified Foresty Costs (by type)
FY2001: $5.949 million



Source: DNR Division of Forestry

- Timber Sales costs are allocated to all lands in proportion to the revenues received from those lands. For example, in FY 2000, 49 percent of all state timber sales revenues were from Permanent School Fund (PSF) lands, so 49 percent of all state timber sales costs were attributed to the PSF lands.
- Division of 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 and every 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 by the Division of Forestry are deposited in the Forestry Suspense Account. Certified costs of management are deducted from the gross and transferred to the State's Unrestricted General Fund. The remaining net revenues are then deposited into the Permanent School Fund at the end of each fiscal year.

The trust land cost certification process has been reviewed twice in recent years (FY 1993 and FY 1997) by the Office of the Legislative Auditor (OLA).[14] In the final 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 for change have been implemented.

Changes to Mineral Management Costs on Trust Lands

Except for a one-time appropriation in fiscal year 1997 from the revenue on university trust fund lands, all the revenue from state mineral leases covering school and university fund lands has been deposited into the corpus of the funds.

Starting in fiscal year 2002, for a five-year period, an administration and management fee is being certified against revenue from state taconite leases covering the school and university fund lands. Laws of Minnesota 2001, First Special Session, Chapter 6, Sections 1-3, provides that 20 percent of the annual payments received under state taconite leases covering school and university fund lands is transferred to the general fund, with the remaining payments transferred to the corpus of the permanent school fund and permanent university fund. This fee is applied only to iron ore/taconite leases, not other kinds of mineral rights activities.

This law also provides that an amount of money equal to such money transferred to the general fund is appropriated to the DNR Commissioner and the board of regents of the University of Minnesota for grants to the taconite mining companies to improve taconite pellet production, value-added production of taconite, and cost-savings production improvements at Minnesota's taconite plants.

[14] Minnesota Legislature, Office of the Legislative Auditor, *School Trust Land, A Program Evaluation Report* (St. Paul, 1998); and Minnesota Legislature, Office of the Legislative Auditor, *Department of Natural Resources Fiscal Year 1993 Statewide Audit, No. 94-06* (St. Paul, 1994).

V. Review of 2000-1 Projects

Forestry Projects

In 2001, the DNR convened 100 leaders from Minnesota's diverse forest interests at a Forest Summit to explore opportunities to enhance forest management in the state. Partners at the Forest Summit established Minnesota's first cooperative demonstration forest. The Bear River Demonstration Forest is an action-based project to apply, test, and showcase innovative and traditional forest management practices aimed toward improving timber productivity and quality, and sustaining or enhancing economic, social and environmental integrity. It encompasses 240,000 acres of forest land and involves eight major landowners (i.e., federal, state, two counties, and four forest industry companies). The DNR administers approximately 80,000 acres of land in the demonstration forest, a substantial portion of which are school trust lands.

The 2001 Legislature appropriated $1.25 million to the DNR for the FY 2002/2003 biennium for timber sales. The funding is intended to be used to offer for sale the backlog of state land timber previously identified in adopted forest resource management plans that has not yet been sold due to lack of staff to do the field work. In addition, the DNR would offer for sale additional volumes of timber from commercial thinnings. In total from the backlog and additional thinning volume, the DNR will be offering for sale an additional 202,000 cords of state timber each year for the next three years. This initiative will provide an opportunity for additional revenues for the Permanent School Trust.

Minerals Projects

Metallic mineral lease sales and lease issuance

During the past two fiscal years, two metallic minerals lease sales were held. [15] In addition to the leases sold at public auction, metallic mineral leases can also be obtained from a group of mining units that are available by application from the preference rights list, available on the DNR's website or by request. Interested parties may also obtain mineral rights leases from the state through negotiation.

FY 2000
While there were no metallic minerals lease sales in FY 2000 (the previous sale was in April 2000), there were 11 preference rights leases and six negotiated metallic mineral leases issued during this fiscal year. These leases covered about 6,136 gross acres with 2,361 acres of school trust land included.

[15] During a metallic minerals lease sale, interested parties can bid upon areas of land called mining units, which contain designated areas of state-owned mineral rights within a township. Leases are sold at public auction, which are usually held once per year. In order to bid on a mining unit at public auction, the bidder must submit a sealed bid that includes an application fee of $100 plus rental for one full calendar year. Rental is calculated at $1.50 per acre times the gross acreage of the lands offered for lease.

The bidding party also submits a royalty bid rate that will be added over and above the base rate (the base rate is a progressive percentage of the market value of the ore, which has been determined to be a fair rate of return to the state on any metallic minerals). The bidder submitting the highest bid rate on a mining unit receives a mineral lease for that mining unit if all other statutory requirements of the bidding party are met. For example, if one bidder submits a royalty bid rate of 0.1000% for a mining unit, while second bidder submits 0.1500% for the same mining unit, the second party would receive the lease, if all other requirements were met.

FY 2001
The 24th sale of state metallic mineral leases was held on October 17, 2001 in Duluth. Metallic minerals lease were offered in an area covering about 464,000 acres in Carlton, Cook, Lake, and St. Louis counties. A total of 56 metallic minerals leases, including about 20,000 acres, were awarded after the sale to eight parties. [16] Of the 20,000 acres leased, about 6,700 acres were school trust land, with about 240 acres in Carlton County, 2,690 acres in Lake County, and 3,780 acres in St. Louis County.

In addition, nine negotiated metallic minerals leases were issued in FY 2000, along with 10 preference right metallic minerals leases. These leases encompassed a total of about 7,900 acres, including 4,360 acres of school trust land in Aitkin, Carlton, Lake, and St. Louis counties.

Outlook for FY 2002
The 25th sale of state metallic mineral leases was held on July 17, 2001 in St. Paul. The acreage offered in this sale totaled over 443,000 acres in Aitkin, Lake, and St. Louis counties. Over 135,000 of these acres offered were school trust. A total of 126 metallic mineral leases were awarded after the sale to eight parties. [17] The leases include 27,860 acres, with 7,440 acres of school trust land in Lake County and 4,990 acres school trust land in St. Louis County.

Additional leases awarded include 17 preference rights leases covering 7,447 acres in St. Louis County. These leases include 40 acres of school trust lands. Eight negotiated leases for 1,411 acres in Carlton County are were also awarded, with 200 acres of school trust land.

The DNR is currently planning to hold a metallic minerals lease sale in the summer of 2002 and the summer of 2003. These sales will include school trust fund lands and are expected to generate rental income.

Land Sales

FY 2000
No DNR state land was sold during FY 2000 through the Division of Lands and Minerals.

FY 2001
In July 2000, 11 parcels were offered for sale at public auction. The parcels included five parcels of trust land, five acquired land parcels, and one Volstead parcel. All five of the trust land parcels, totaling 100.7 acres, sold at auction for a total of $69,938. The trust fund parcels were located in the counties of Cook, Itasca, and St. Louis.

Outlook for FY 2002
A land sale was held in October of 2001, in which there were 20 parcels of land offered for sale through public auction. Of the 20 parcels offered, 13 of the parcels were school trust land, while the other seven were acquired land. Nine of the trust fund parcels, totaling about 237 acres, were sold during the auction for a total of $156,630. Counties with trust land parcels sold include Beltrami, Mille Lacs, Morrison, St. Louis, Stearns, and Wadena. Payments from the land sale were to be collected in full within 90 days of the sale date. This revenue will be reported in the FY 2002 receipts.

[16] At the FY 2001 sale, a total of eight parties submitted 65 bids on 56 mining units. The average bid rate on all of the mining units was 0.1649%, with the lowest bid rate at 0.0000% and the highest bid rate at 0.5100%.
[17] During the FY 2002 sale, 10 parties submitted 133 bids on 126 mining units. The average bid rate was 0.2560% with a minimum bid of rate 0.0000% and a maximum bid rate 1.0500%.

The DNR is currently planning to hold a land sale in the fall of 2002. The trust fund parcels not sold in 2002 included three platted lots on White Iron Lake near Ely. The DNR plans to offer these parcels for sale again in 2002. It is likely that additional school trust fund parcels will be offered as well.

Land Exchange Projects Involving School Trust Land

By law, trust fund land cannot be sold directly to an interested party, but rather must be sold at public auction. In some cases, such as with the lakeshore property that had been previously leased to individuals, the lessees wanted the opportunity to purchase the land directly. In order to sell lakeshore and commercial property to individuals and corporations, several land exchanges have been in process during recent fiscal years.

Lakeshore Lease Lot Land Exchange Project

In its 1998 session, the Minnesota Legislature required the DNR to exchange its remaining 576 lakeshore lots being leased to private individuals, except for the three leases at Horseshoe Bay in Cook County. The lakeshore lots, most of them school trust lands, would be exchanged for equivalent-value county tax-forfeited lands. The latter would then become school trust lands, while the lakeshore lots would be sold to the former lessees.

Table 6 shows the acreage and value statistics, by county, for this land exchange project. The project received final approval on the last county from the Land Exchange Board at their June 5, 2001 meeting.

Table 6
Lakeshore Lease Lot Land Exchange Project Acreage and Value by State and County

	Exchanged by State:			Exchanged by County :	
County	**Acres**	**Total Value**	**Number of Lots**	**Acres**	**Total Value**
Aitkin	17.8	$346,000	23	98	$346,000
Beltrami	6	$285,000	6	399.8	$285,000
Cass	58.2	$2,470,000	98	2,201.40	$2,470,000
Cook	18.6	$580,000	29	18.6	$580,000
Crow Wing	14	$1,530,000	23	557.9	$1,530,000
Hubbard	14.6	$425,200	23	350.5	$425,200
Itasca	126.8	$2,220,000	123	1,151.00	$2,220,000
Koochiching	7	$245,000	6	363.8	$245,000
Lake	41.2	$520,100	20	18	$520,100
Polk	8.3	$183,500	4	240	$183,500
St. Louis	210	$5,800,000	262	1,154.50	$5,800,000
TOTAL	**522.5**	**$14,604,800**	***617**	**6,553.50**	**$14,604,800**

*This amount represents the 576 remaining leased lakeshore lots and additional state parcels added at the request of counties.

Totals may not add due to independent rounding.
Source: DNR Division of Lands and Minerals.

As Table 6 shows, the state exchanged 522.5 acres of land (most of it school trust status) valued at $14,604,800 for 6,553.5 acres of county tax-forfeited land valued at the same amount. As required by law, the counties are now in the process of selling the leased lakeshore lots to the current lessees.

Commercial (Resort) Leases

There are a total of ten commercial leases, seven of which are leases for privately owned resort operations, on school trust land. The 2000 legislative session authorized the exchange of these leased lands for those lessees who were interested in acquiring the lands they now lease. These land exchanges will be done in the same manner as the state-owned lakeshore lots that were leased to private individuals. Those lots, by legislative directive, will be exchanged with the counties in which they were located. The counties are then required to sell the lots to the current lessees.

Of the ten commercial leases, one was included in the Lake County lakeshore lease lot exchange project. Three additional lessees have thus far requested that they be allowed to acquire the land they now lease. Two of these leases are located in St. Louis County and one is in Cook County. Survey work for these three leases is currently being done so that accurate legal descriptions and acreages can be established for these properties. Following this, the leased lands will be appraised and the counties will then offer equivalent valued land in exchange. The DNR anticipates completing these three land exchanges by December 31, 2002.

Wild Rice Production Leases

There are currently 558 acres of state administered land (most of it school trust land) leased to private individuals who have improved the properties with the installation of dikes and pumping stations and use the parcels for the production of paddy-grown wild rice.

The intent of this project is to exchange wild rice production lands to the counties in which they are located. The counties are then be required by legislation to sell the same lands to the current lessees at a value established by the county boards.

A total of six parcels currently leased by five individuals are involved in this project. Four of these leases are located in Beltrami County with one lease each in Aitkin and Koochiching counties.

The DNR is working cooperatively with the Minnesota Cultivated Wild Rice Council on this exchange project and anticipates presenting these exchanges to the Land Exchange Board for final approval during FY02.

VI. Preview of 2002-3 Issues

Alternative Means of Compensating the Permanent School Fund by non-revenue generating users of School Trust Lands

In accordance with the fiduciary responsibility that is owed to the trust the DNR has an obligation to manage school trust lands in a manner that generates a long-term income to the Permanent School Fund (PSF). [18] Currently about 150,000 acres of trust land are being managed in a manner that restricts, and even precludes income generation. It is the policy of the DNR that if trust land is used for purposes that either restrict or prohibit revenue generation, the DNR seeks other methods of compensating the trust for the foregone revenues.

The Department has previously submitted capital bonding and LCMR funding requests to the Legislature to compensate the school trust for about 5000 acres of trust land located in State Parks and 51,000 acres that were designated by the legislature in 1991 as state Peatland Scientific and Natural Areas. Funding has not been approved to date. Major development activities such as timber cutting or mining would likely not be allowed in these areas.

In addition 93,000 acres of non-revenue generating lands are located in the federally managed BWCAW, where generally the only allowed uses are primitive camping and non-motorized recreation. The school trust lands located in the Boundary Waters present a unique problem to the state in that resolving the restrictions on revenue generation will require negotiation with the federal government. The Minnesota Legislature in 2000 expressed its interest in pursuing a resolution of this matter when it ordered the preparation of a study to be conducted by the University of Minnesota - Duluth (UMD). The study will analyze a representative sample of the trust lands within the BWCAW, and estimate their market value and potential future revenue generating capabilities. The purpose is to produce accurate information about the trust lands within the BWCAW that can be used during discussions between state and federal decision makers. Results of the UMD research study are due in January 2003.

Taconite leases

The taconite companies in Minnesota continue to face economic losses and competition from imported steel subsidized by foreign nations. To aid in the survival of the taconite industry in Minnesota, on March 7, 2001, the State Executive Council approved the issuance of royalty rate reduction amendments to all the state taconite leases. The amendment created a 15 percent reduction in the royalty rate as calculated under the state lease agreements for the period of April 1, 2001 through March 31, 2002. Leases for all current mining operations on school trust land dropped from $0.51 to $0.435 royalty per crude ton, except for LTV Steel Mining Company, which has been in bankruptcy proceedings. The revenue reduction impact to the PSF from this agreement is estimated to be $375,000.

On December 5, 2001, the State Executive Council cancelled the April 2001 rate cut for mining operations on school trust land and approved a second, deeper, royalty rate reduction agreement on these leases. The amendment reduced the base royalty rate on a ton of taconite ore to $0.395, about a 22.5 percent reduction, on state taconite leases on school trust land for the period of January 1, 2002 through June 30, 2003. The purpose of the reduction is to continue to aid the survival of the

[18] Office of the Legislative Auditor, *School Trust Land, A Program Evaluation Report*, p. 13; Minnesota Department of Natural Resources, *School Trust Land Management Report,* pp. 22-24.

taconite industry so that ore will be mined for many years to come.

The revenue reduction impact to the school fund from this second agreement is estimated to be about $2.1 million. While this is a significant revenue reduction, it is balanced against the fact that revenue for fiscal year 2002 and the projected revenues for the next few years will be significantly higher than recent years. This is due to the fact that more mining is planned for the state properties and the fact that there are no longer any state leases at the $.05 per ton rate that existed for leases issued prior to 1951.

VII. Management of the Permanent School Fund and Income Payments to Public Schools [19]

The State Board of Investment (SBI) is the agency that manages the Permanent School Fund (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; it must remain perpetual and inviolate. Since the fund's origination in the 1850's the market value of the principal within the PSF has grown to about $549 million, nearly all generated from land and timber sales, land leases, and mineral taxes and royalties. During the past fiscal year (ending June 30, 2001) income to the PSF from school trust lands was about $9.8 million.

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. [20] During FY 2001 $24 million of spendable income was distributed in this manner. This represents about 0.7% of Minnesota's most recent school aid amount ($3.36 billion) that was appropriated during the 2001 Legislative Session.

As of June 30, 1999 (the beginning of the past biennium) the market value of the PSF was $558 million. During fiscal year 2000 revenue from the management of school trust lands was $6.7 million and payments to schools was $21 million. During that fiscal year the market value of the PSF grew to $579 million (as of June 30, 2000). During fiscal year 2001 the market value of the PSF reflected the general decline in the stock market. The fund's market value retreated to $549 million while both the revenue from natural resources and the payments to schools ($9.7 million and $24 million, respectively) rose from the previous year's levels.

[19] Data in this section was provided by the State Board of Investment.
[20] Office of the Legislative Auditor, p. 101.

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On the front cover: School trust land, like this lakeshore parcel on White Iron Lake near Ely, may be offered for sale for the benefit of the Permanent School Fund. Photograph copyright Minnesota DNR.