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CONSTITUTIONAL AMENDMENTS AT THE 1984 ELECTION

RELATING TO THE
PERMANENT SCHOOL FUND

A BACKGROUND PAPER

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During the 1984 session the Legislature passed and the Governor signed two bills proposing constitutional amendments affecting the Permanent School Fund. (See attached appendices.) The first one would allow the exchange of state-owned lands for other publicly-owned lands, which is currently prohibited by the Constitution. The second one would remove the constitutional limits on the investment of the Permanent School Fund and allow limits on the investments to be set by law, as well as allow the distribution of the income from the investments to be set by law. This paper provides an overview of the Permanent School Fund and explains the rationale behind the passage of the two proposed constitutional amendments.

I. OVERVIEW

The Permanent School Fund (PSF) is made up of two parts: (1) lands granted to the state by the federal government that have been consolidated into PSF land; and (2) cash and investments generated from land sales, mining royalties, timber sales and lakeshore and other leases. The Department of Natural Resources (DNR) has responsibility for management of the land and the State Board of Investment is responsible for investment of the principal of the fund.

A. Lands

1. A total of 2,900,000 acres of school lands was granted to the state in the Enabling (Statehood) Act of 1857. This land consisted of sections 16 and 36 of most townships.
2. A total of 4,777,636 acres of swamp lands was granted to the state in 1860. Most of this acreage was sold or granted away but the remaining 1,560,000 acres were combined with the PSF lands by a 1962 constitutional amendment.
3. A total of 500,000 acres was granted to the state as internal improvement lands in 1866. All but 6,677 acres of this land were sold and a 1974 constitutional amendment transferred all remaining land, cash, and investments of the improvement lands to the PSF.

Of the lands granted to the state under the three programs, 2,520,303 acres remain in the fund. Most of these remaining lands are in the northern part of the state--86 percent is located in Koochiching, St. Louis, Itasca, Lake, Cass, Aitkin and Cook Counties. Of the 2.5 million acres, 1.7 million acres are in DNR management units as follows:

State Forests	1,604,783	acres
Wildlife Management Areas	96,377	"
State Parks	9,717	"
Wild & Scenic Rivers	645	"
State Waysides	640	"
State Trails	238	"
Public Access	204	"

The remaining 808,000 acres are managed by DNR outside any established management area. These acres are primarily forestry lands but also include mineral, agricultural and lakeshore lands and other smaller categories. In addition to the 2.5 million acres of land, the PSF also includes the severed mineral rights only for another 989,462 acres.

B. Principal

The principal of the permanent school fund must remain perpetual and inviolate forever (Minnesota Constitution, Article XI, Section 8). The principal of the PSF is \$322 million as of March 31, 1984. The principal is managed by the Department of Finance and invested by the State Board of Investment. The income from the investment of the principal is distributed to the school districts based on their 5-21 year old student population. The principal of the fund has been generated from the following sources:

1. Mining royalties. About 44 percent of the principal of the PSF has been generated by the royalties paid to remove minerals.
2. Occupation tax. Approximately 35 percent of the PSF principal has come from mineral exploration leases. These are leases to explore and occupy the land.
3. Timber sales. Approximately 12 percent of the PSF principal has come from sales of timber on PSF land.
4. Land sales, other leases, etc. The remaining nine percent of the PSF principal has come from the sale of PSF land, from lakeshore leases, wild rice leases, agricultural leases, utility leases and other commercial leases. Although about two-thirds of the PSF land has been sold, the sale of land has contributed less than nine percent of the principal of the PSF.

C. Permanent School Fund Advisory Committee

In June, 1981, the Legislative Audit Commission issued a report that pointed out a number of areas where management of the PSF could be improved. In response to this, the 1982 Legislature established the Permanent School Fund Advisory Committee. This committee, made up of the chairs of the House and Senate Education Committees, the chairs of the House Appropriations Committee and Senate Finance Committee, the Commissioner of Education and two school district superintendents, has been meeting since the summer of 1982.

D. Proposed Constitutional Amendments at the 1984 Election

Two bills proposing constitutional amendments were introduced and passed by the 1984 Legislature as a result of this advisory committee's activities. These amendments will be before the voters in the November general election. The approval of a majority voting at the election is needed to ratify a constitutional amendment. The amendment will be effective upon ratification.

II. PROPOSED CONSTITUTIONAL AMENDMENTS IN 1984
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Amendment No. 1 -- Public Lands: Allowing Exchange

"Shall the Minnesota Constitution be amended to allow the exchange of state-owned lands for other lands owned by the state or local governments?"

The DNR has established the following goal for the management of PSF land: "...to secure the maximum long-term economic return from the school trust lands consistent with sound natural resource conservation and management principles and specific policy guidance as provided by law."

The Constitution allows PSF land to be exchanged with federal land or privately-owned land. However, the Constitution does not allow the exchange of PSF land for other state-owned land or for land owned by local governments. In passing this proposed constitutional amendment, the Legislature recognized that the current prohibition limits the flexibility of the DNR in managing the PSF lands in a manner that could increase revenue for the PSF.

The only alternative now available for making exchanges involving PSF land is to first condemn the PSF land, compensate the PSF, and then exchange the land as regular state land. This process has two disadvantages. It requires a legislative appropriation to compensate the PSF, and it requires the PSF to give up the revenue-earning potential of the land for a fixed amount of cash, rather than for other income-generating land.

If PSF land could be exchanged for other state lands, more PSF land located in non-income earning areas such as state parks and waysides could be exchanged for other state lands that could generate income for the PSF. Removal of the exchange limitations could also allow for consolidation of scattered parcels of PSF land for more efficient management.

If ratified by the voters, this proposed 1984 constitutional amendment dealing with state land exchanges would allow PSF land to be exchanged for other lands of the state and of local governments, as well as for federal and private land. The exchanges would be subject to the land exchange process currently in law which is administered by the DNR and requires approval of the State Land Exchange Board, which is composed of the Governor, Attorney General and State Auditor.

Amendment No. 2 -- School Fund: Removing Investment Restrictions

"Shall the Minnesota Constitution be amended to remove constitutional restrictions on the investment of the permanent school fund and to allow the limits on the investment of the fund and the apportionment of the returns on the investment to school districts to be set by law?"

The permissible scope of authorized investments of Minnesota's school fund is currently found in Article XI, Section 8 of the state constitution and is very restrictive. In most other states the parameters for investing the school trust funds are set statutorily rather than constitutionally, and are generally less restrictive than the Minnesota provisions.

The state constitution currently limits the investment of the Permanent School Fund to a restricted range of corporate bonds (up to 40% of the fund), corporate stocks (up to 20% of the fund), and government securities (unlimited percentage of the fund).

The proposed constitutional amendment, passed by the 1984 Legislature, would remove these limits from the constitution and allow the limits to be set in statute. If ratified by the voters, the investment of the Permanent School Fund would be subject to the same investment restrictions which govern the state's retirement funds, unless later altered by the Legislature.

The rationale for this constitutional amendment is that the current constitutional limitations on the investments have effectively lowered the amount of income earned by the fund and distributed to the school districts each year. The State Board of Investment has estimated that, over the last ten years the state has lost as much as \$28.5 million in potential income as a result of the current constitutional limitations.

For example, over the last ten years, the Permanent School Fund could have earned an additional \$11.7 million by investing in A rated industrial bonds or an additional \$28.5 million by investing in BBB rated industrial bonds instead of government agency securities. In 1983, the yield for A rated bonds was 5.38% higher than that from the authorized government securities and the yield for BBB rated bonds was 8.10% higher. Both the A and BBB rated industrial bonds are authorized investments for state retirement funds but currently are not authorized investments for the Permanent School Fund.

This proposed amendment would also remove the obsolete constitutional language requiring the income from the investments to be distributed to schools on the basis of their 5-21 year old population. If ratified, the distribution of the proceeds would be set by statute, using the more specific definition of pupils actually in attendance at school. The current constitutional requirement is the only reason that the districts must report the number of their 5-21 year old student population.

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CHAPTER 643-H.F.No. 1559

An act proposing an amendment to the Minnesota Constitution, article XI, section 10; allowing public lands of the state to be exchanged for any other public land; amending Minnesota Statutes 1982, sections 94.343, subdivision 1; and 94.349, subdivision 3.

10 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MINNESOTA:

11 Section 1. [CONSTITUTIONAL AMENDMENT PROPOSED.]

12 Subdivision 1. The following amendment to the Minnesota
13 Constitution, article XI, section 10, is proposed to the
14 people. If the amendment is adopted, the section shall read as
15 follows:

16 Sec. 10. As the legislature may provide, any of the public
17 lands of the state, including lands held in trust for any
18 purpose, may be exchanged for ~~lands-of-the-United-States~~ any
19 publicly or privately held lands with the unanimous approval of
20 the governor, the attorney general and the state auditor. Lands
21 so acquired shall be subject to the trust, if any, to which the
22 lands exchanged therefor were subject. The state shall reserve
23 all mineral and water power rights in lands transferred by the
24 state.

25 Sec. 2. [SUBMISSION TO VOTERS.]

26 The proposed amendment shall be submitted to the people at
27 the 1984 general election. The question submitted shall be:

28 "Shall the Minnesota Constitution be amended to allow the
29 exchange of state-owned lands for other lands owned by the state
30 or local governments?

1 Yes

2 No"

3 Sec. 3. Minnesota Statutes 1982, section 94.343,
4 subdivision 1, is amended to read:

5 Subdivision 1. Except as otherwise herein provided, any
6 Class A land may, with the unanimous approval of the board, be
7 exchanged for ~~land-of-the-United-States~~ any publicly held or
8 privately owned land in the manner and subject to the conditions
9 herein prescribed. The commissioner, with the approval of the
10 board, shall formulate general programs of exchange of Class A
11 land designed to serve the best interests of the state in the
12 acquisition, development, and use of lands for purposes within
13 the province of the department of natural resources.

14 Sec. 4. Minnesota Statutes 1982, section 94.349,
15 subdivision 3, is amended to read:

16 Subd. 3. The classes of state land which may be involved
17 in a transfer of title are the same as those which may be
18 exchanged under land exchange laws and are subject to the same
19 limitations as are applied to state lands under land exchange
20 laws. ~~In-addition, land-subject-to-the-public-sale-requirements~~
21 ~~of-Minnesota-Constitution, Article XI, Section 8, shall be~~
22 ~~condemned prior to any title transfer.--The condemnation award~~
23 ~~must be paid and the time to appeal from the award must have~~
24 ~~expired prior to any title transfer under this section.~~

25 Sec. 5. [EFFECTIVE DATE.]

26 Sections 3 and 4 are effective upon ratification of the
27 amendment proposed in section 1.

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CHAPTER 482-H.F.No. 1291

An act proposing an amendment to the Minnesota Constitution, article XI, section 8; removing the constitutional restrictions on permanent school fund investments; establishing statutory restrictions; amending Minnesota Statutes 1982, section 11A.16, subdivision 4.

10 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MINNESOTA:

11 Section 1. [CONSTITUTIONAL AMENDMENT.]

12 The following amendment to the Minnesota Constitution,
13 article XI, section 8, is proposed to the people. If the
14 amendment is adopted, article XI, section 8, will read as
15 follows:

16 Sec. 8. The permanent school fund of the state consists of
17 (a) the proceeds of lands granted by the United States for the
18 use of schools within each township, (b) the proceeds derived
19 from swamp lands granted to the state, (c) all cash and
20 investments credited to the permanent school fund and to the
21 swamp land fund, and (d) all cash and investments credited to
22 the internal improvement land fund and the lands therein. No
23 portion of these lands shall be sold otherwise than at public
24 sale, and in the manner provided by law. All funds arising from
25 the sale or other disposition of the lands, or income accruing
26 in any way before the sale or disposition thereof, shall be
27 credited to the permanent school fund. Within limitations
28 prescribed by law, the fund shall be invested to secure the
29 maximum return thereon consistent with the maintenance of the
30 perpetuity of the fund, ~~and with the approval of the board of~~

1 investment, the fund may be invested in:--(1) interest-bearing
2 fixed-income securities of the United States and of its
3 agencies, fixed-income securities guaranteed in full as to
4 payment of principal and interest by the United States, bonds of
5 the state of Minnesota or its political subdivisions or
6 agencies, or of other states, but not more than 50 percent of
7 any issue by a political subdivision shall be purchased;--(2)
8 stocks of corporations on which cash dividends have been paid
9 from earnings for five consecutive years or longer immediately
10 prior to purchase, but not more than 20 percent of the fund
11 shall be invested therein at any given time nor more than one
12 percent in stock of any one corporation, nor shall more than
13 five percent of the voting stock of any one corporation be
14 owned;--(3) bonds of corporations whose earnings have been at
15 least three times the interest requirements on outstanding bonds
16 for five consecutive years or longer immediately prior to
17 purchase, but not more than 40 percent of the fund shall be
18 invested in corporate bonds at any given time.--The percentages
19 referred to above shall be computed using the cost price of the
20 stocks or bonds. The principal of the permanent school fund
21 shall be perpetual and inviolate forever. This does not prevent
22 the sale of any public or private stocks or bonds investments at
23 less than the cost to the fund; however, all losses not offset
24 by gains shall be repaid to the fund from the interest and
25 dividends earned thereafter. The net interest and dividends
26 arising from the fund shall be distributed to the different
27 school districts of the state in proportion to the number of

1 students-in-each-district-between-the-ages-of-5-and-21-years in
2 a manner prescribed by law.

3 A board of investment consisting of the governor, the state
4 auditor, the state treasurer, the secretary of state, and the
5 attorney general is hereby constituted for the purpose of
6 administering and directing the investment of all state funds.
7 The board shall not permit state funds to be used for the
8 underwriting or direct purchase of municipal securities from the
9 issuer or his the issuer's agent.

10 Sec. 2. [QUESTION.]

11 The proposed amendment shall be submitted to the people at
12 the 1984 general election. The question submitted shall be:

13 "Shall the Minnesota Constitution be amended to remove
14 constitutional restrictions on the investment of the permanent
15 school fund and to allow the limits on the investment of the
16 fund and the apportionment of the returns on the investment to
17 school districts to be set by law?

18 Yes

19 No"

20 Sec. 3. Minnesota Statutes 1982, section 11A.16,
21 subdivision 4, is amended to read:

22 Subd. 4. [INVESTMENT.] The permanent school fund shall be
23 invested by the state board in-the-following-securities-as
24 directed-by-article-XI, section-8-of-the-constitution-of-the
25 state-of-Minnesota:

26 (a)-Interest-bearing-fixed-income-securities-of-the-United
27 States-and-its-agencies, including securities fully guaranteed

1 by-the-United-States,-bonds-of-Minnesota-or-its-political
2 subdivisions-or-agencies,-or-of-other-states-but-not-more-than
3 50-percent-of-any-issue-by-a-political-subdivision;

4 (b)-Stocks-of-corporations-with-cash-dividends-paid-from
5 earnings-for-the-five-consecutive-years-prior-to-purchase,-but
6 not-more-than-20-percent-of-the-fund-shall-be-invested-therein
7 nor-more-than-one-percent-in-stock-of-any-one-corporation,-nor
8 more-than-five-percent-of-the-voting-stock-of-any-one
9 corporation-shall-be-owned;

10 (c)-Bonds-of-corporations-whose-earnings-have-been-at-least
11 three-times-the-interest-requirements-on-outstanding-bonds-for
12 five-consecutive-years-or-longer-immediately-prior-to-purchase,
13 but-not-more-than-40-percent-of-the-fund-shall-be-so-invested;

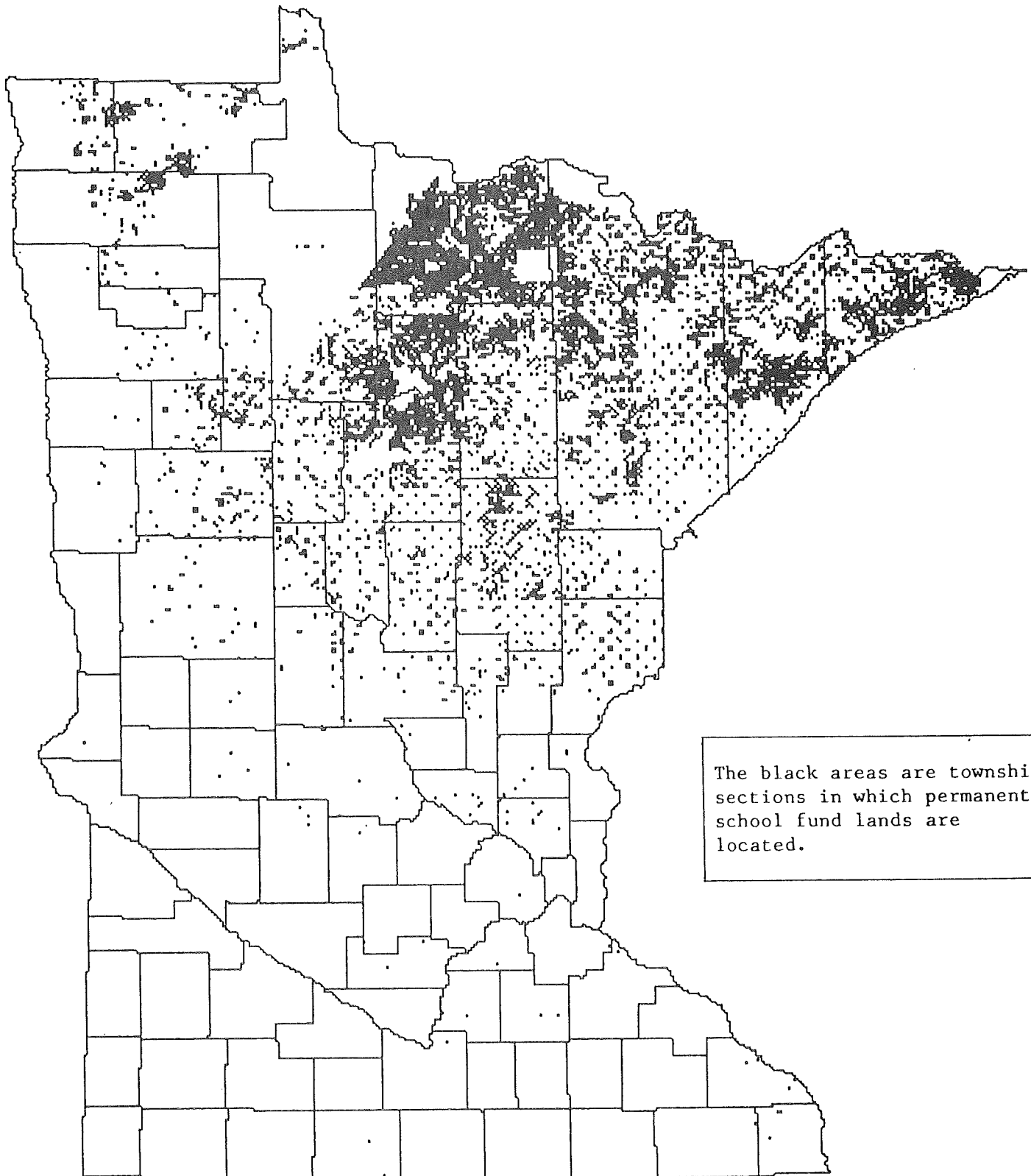
14 (d)-The-percentages-referred-to-above-shall-be-computed
15 using-the-cost-price-of-the-stocks-or-bonds subject to the
16 provisions of section 11A.24.

17 Sec. 4. [EFFECTIVE DATE.]

18 Section 3 is effective upon ratification of the amendment
19 proposed in section 1.

20 . Approved April 25, 1984

1983 TRUST FUND LANDS



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