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 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 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. 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. The first of those reports was published in February 2002. This is the second 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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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]

The Constitution established the Permanent School Fund (PSF).[6] 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 12/31/03
School	2,900,000	946,950
Swamp	4,706,503	1,551,640
Internal Improvement	500,000	6,630
Total	8,106,503	2,505,220

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

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]

2. Minnesota's trust land today.

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

Minnesota's substantial trust lands, and the income they generate, make Minnesota more like western states (which generally still manage significant amounts of land and mineral resources for a variety of trusts) than eastern states (which generally disposed of trust lands permanently). For example, of Minnesota's immediate neighbors, as of 1997 Iowa had no school trust lands, and Wisconsin has less than 5,000 acres. The Dakotas each manage over 600,000 acres of school trust land.[9]

3. Revenue from school trust lands, FY02-03.

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 taconite iron ore removed from trust land, leases to remove peat, non-ferrous metallic mineral leases, and several other types of mineral rights use.

3.1 Total gross revenue.

In **FY02** (July 1, 2001 to June 30, 2002), the gross revenue from activities on school trust lands was about **$13.5 million** (Figure 3).

- Timber sales contributed a total of about $7.15 million.
- Leases accounted for about $5.5 million. Included in this category were mineral leases, which brought in about $4.67 million, and leasing of DNR lands, which earned $865,960.

7 Minnesota Department of Natural Resources, School Trust Land Management Report, St. Paul, 1983. p. 10-12.
8 Ibid., p. 14-15.
9 Office of the Legislative Auditor, p. 18.

Figure 1. Minnesota's school trust lands (September 2003).

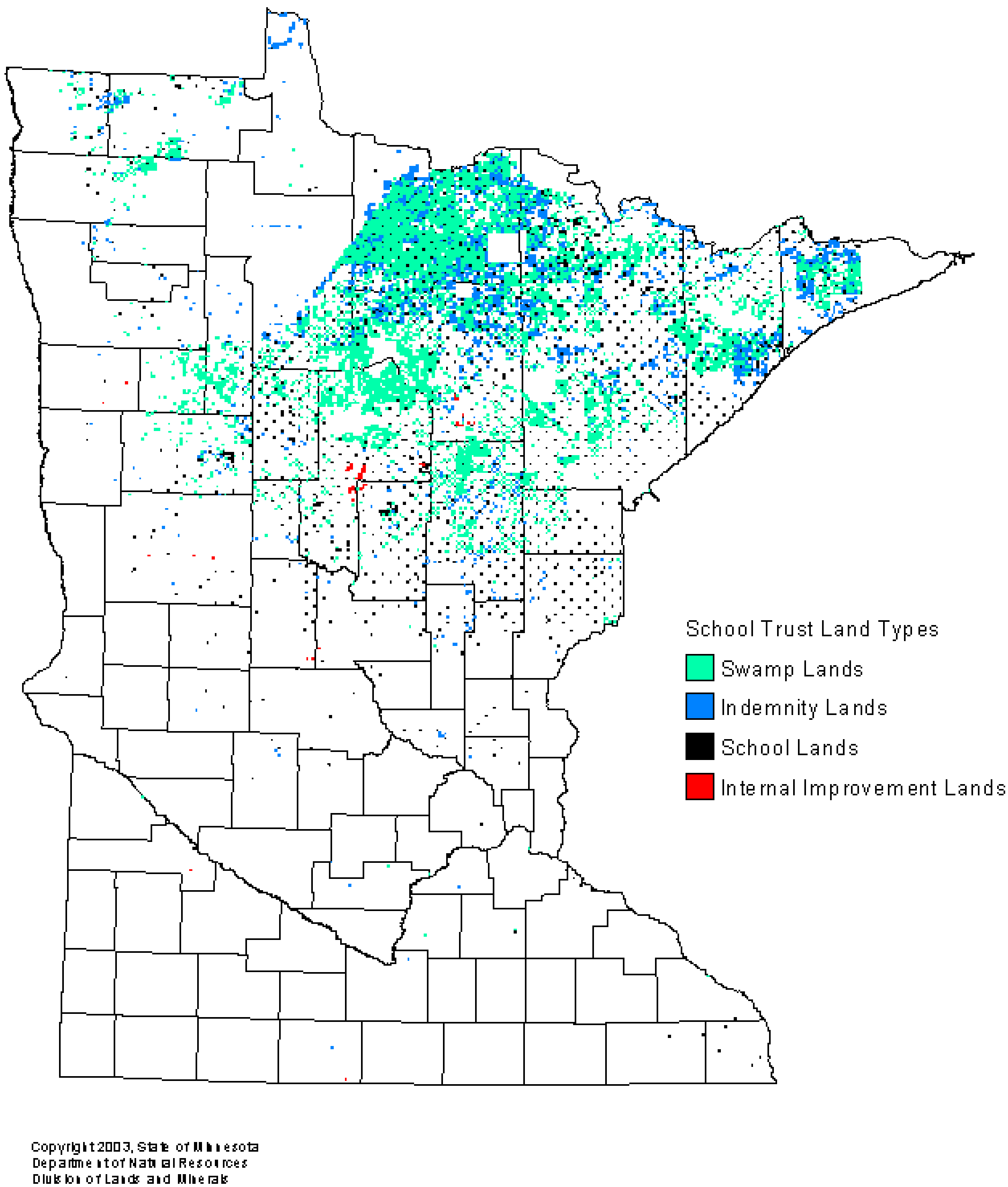
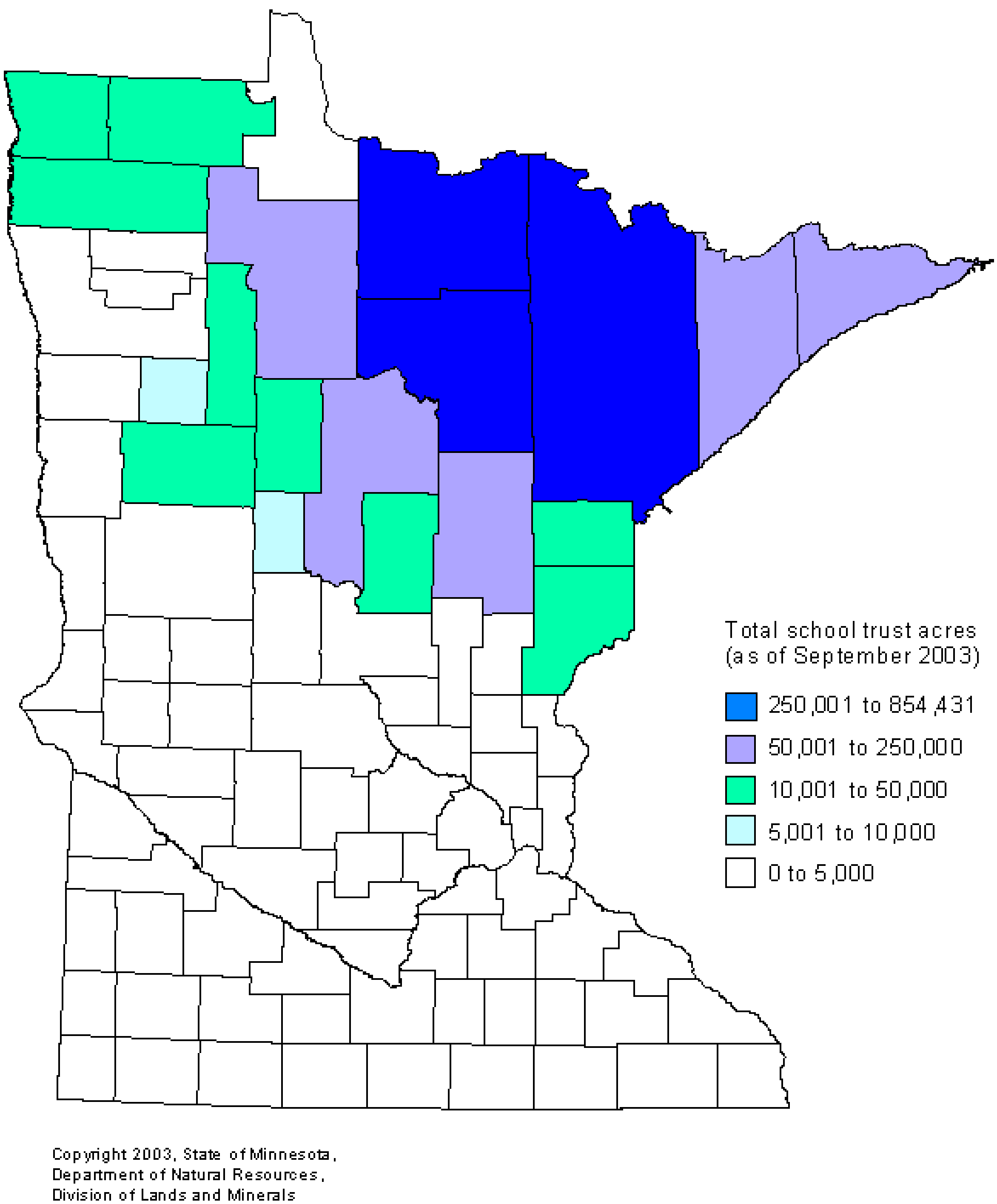


Figure 2. Minnesota's school trust lands by county (September 2003).



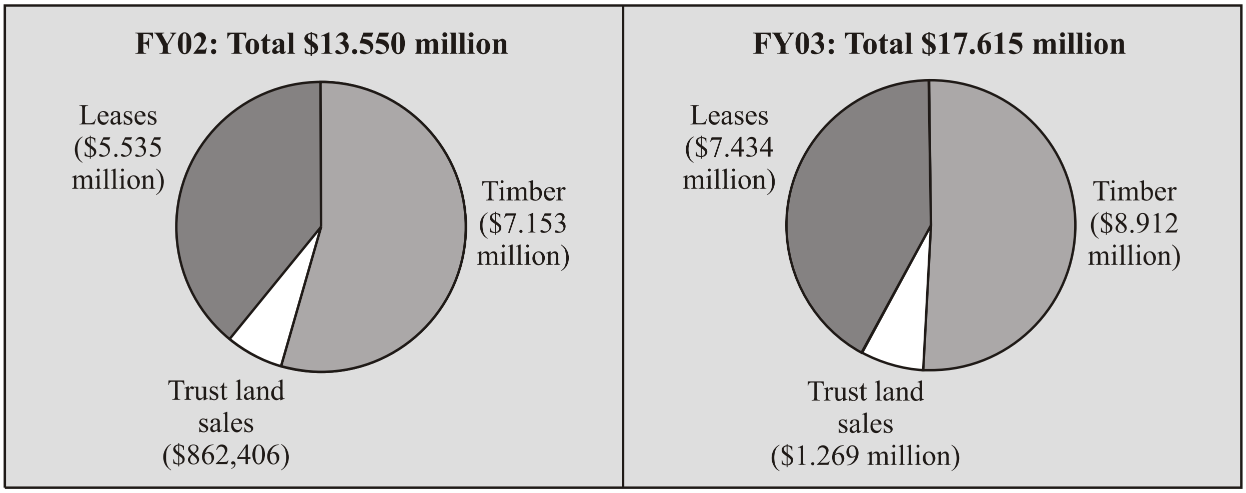


Figure 3. Gross revenue from school trust lands, FY02-03.

- Sale of trust land totaled $862,406, including more than $538,582 in installment payments on land sold in previous years.

In **FY03** (July 1, 2002 to June 30, 2003), the gross revenue from activities on school trust lands was about **$17.6 million** (Figure 3).

- Timber sales contributed a total of about $8.91 million.
- Leases accounted for about $7.4 million. Included in this were mineral leases (about $6.70 million), and leasing of DNR lands (about $728,000).
- Sale of trust land totaled about $1.26 million, including more than $1.05 million in 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 certification costs and is first deposited into the State Forest Suspense Account. Revenue from mineral activities and sales of trust land have not generally been permitted to charge management costs. For FY02, the Legislature changed the way some mineral management costs were handled (see section 4).

In **FY02** (July 1, 2001 to June 30, 2002), net revenue to the school trust fund was over **$7.2 million** (Figure 4).

- About $2.56 million came from the Forestry Suspense Account.
- About $3.78 million came from mineral leasing activities (20% of gross mineral revenue was transferred to the general fund in FY02; see Section 4.2 for details), and
- $862,406 came from trust land sales.

In **FY03** (July 1, 2002 to June 30, 2003), net revenue to the school trust fund was over **$11.6 million** (Figure 4).

- About $3.68 million came from the Forestry Suspense Account.
- About $6.70 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 $1.26 million came from trust land sales.

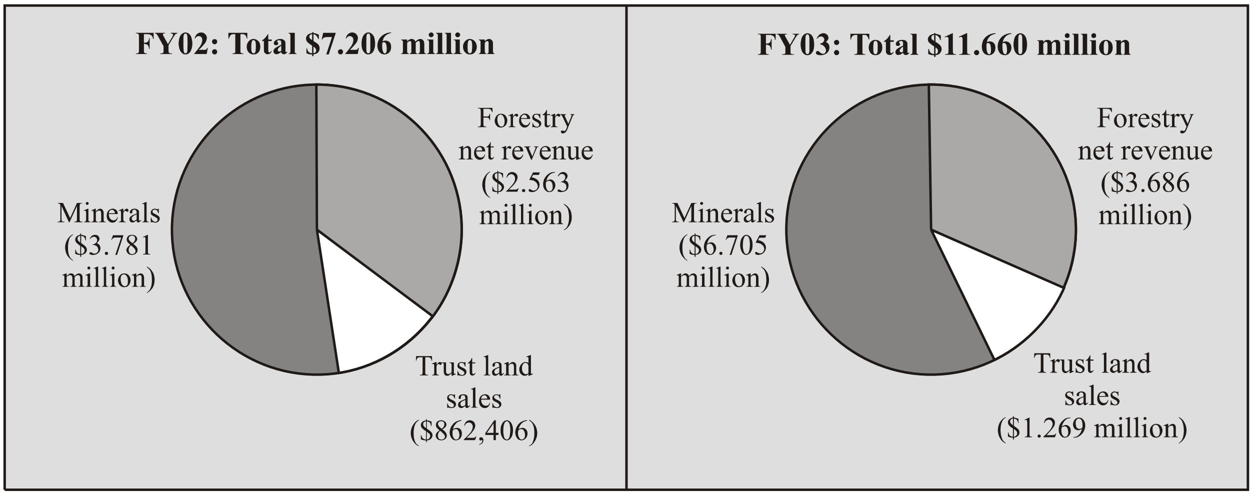


Figure 4. Net revenue to the school trust fund, FY02-03.

3.3 Revenue from minerals activities.

In FY02, revenue generated from minerals activities totaled **$4.668 million** (Table 2). The largest contributor to this figure was $4.491 million from taconite iron ore rents and royalties. Other contributing categories were non-ferrous metallic minerals (about $58,600), stockpiling/surface leases (about $27,900), peat lease royalties (about $59,300), and M-leases (leases for stockpiled, low-grade iron materials), which contributed about $31,300.

Table 2. Revenue from mineral leases, FY02-03.

	FY02	FY03
Taconite Iron ore rents/royalties	$4,491,399	$6,580,046
Non-ferrous metallic minerals	$58,644	$42,964
Stockpiling/Surface leases	$27,901	$4,320
Peat	$59,294	$44,082
M-leases	$31,283	$33,703
Industrial minerals	$189	$189
Total	**$4,668,710**	**$6,705,304**

In FY03, revenue generated from minerals activities totaled **$6.705 million** (Table 2). The largest contributor to this figure was $6.580 million from taconite iron ore rents and royalties. Other contributing categories were peat lease royalties (about $44,100), non-ferrous metallic minerals (about $43,000), stockpiling/surface leases (about $4,300, and M-leases (leases for stockpiled, low-grade iron materials), which contributed about $33,700. (Figure 5 depicts school trust revenue from minerals vs. time for FY92-03.)

Trends in revenue from minerals
The peak in revenue in FY98 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. Beginning FY01, revenue increased due to an increase in mining on state owned lands and the expiration of long term leases with low rates.

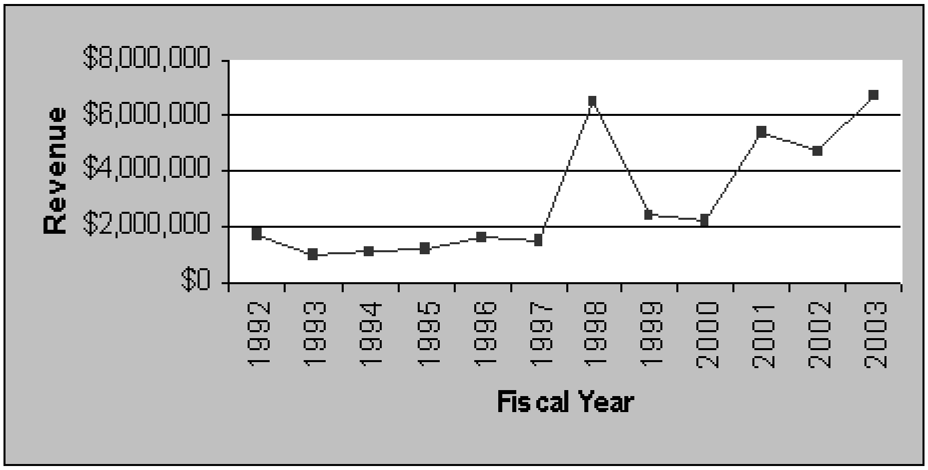


Figure 5. School trust fund revenue from minerals, FY92-03.

3.4 Revenue from land sales.

In **FY02**, the sale of trust land generated a total of **$862,405** (Table 3). This included installment payments of $538,582 and sale of land payments of $120,705. There were also loan interest payments of $134,271, and land sale service charges of $30,051. Sale of timber from sold trust fund land was also included in this group, contributing $38,796. (This is separate from the sales of standing timber; that data is presented in Table 4).

In **FY03**, the sale of trust land generated a total of **$1,268,910** (Table 3). This included land sale installment payments of $1,054,457 and sale of land payments of $86,215. There were also loan interest payments of $104,665 and land sale service charges of $15,339. Timber sold from sold trust land brought in $8,234.

Table 3. Revenue from land sales, FY02-03.

	FY02	**FY03**
Sale of Land (down payments and paid-in-fulls)	$120,705	$86,215
Sale of Land (installment payments)	$538,582	$1,054,457
Land Sale Service Charge [A]	$30,051	$15,339
Sale of Standing Timber [B]	$38,796	$8,234
Loan Interest	$134,271	$104,665
Total	$862,405	$1,268,910

[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 Forestry, which is shown in Table 4.

3.5 Revenue from timber sales and surface leasing activities.

3.5.1 Timber sales.

In FY02 and FY03, timber revenues included timber sales and timber sales interest, which are collected by the Division of Forestry.

1. In FY02, timber sales receipts totaled over $7.1 million, with timber sale interest bringing in about $5,100. All of this revenue was deposited into the Forestry Suspense Account, for certification at the end of the year (Table 4, Figure 6).

2. In FY03, timber sale receipts totaled almost $9 million, with timber sale interest bringing in over $10,000. All of this revenue was deposited into the Forestry Suspense Account (Table 4, Figure 6).

Table 4. Revenue from Division of Forestry timber sales and surface leasing activities, FY02-03.

	FY02	FY03
Timber sales	$7,127,610	$8,892,200
Timber sales interest	$5,100	$10,740
Sale of standing timber [A]	$20,330	$8,970
Subtotal; timber sales	$7,153,040	$8,911,910
Leases, licenses, easements [B]	$865,965	$728,614
Campground fees	$127,920	$136,580
Subtotal; surface leasing	$993,885	$865,194
Total	**$8,146,925**	**$9,777,104**

[A] This is for removal of timber in path of utility line installation, and is distinct from sales of standing timber on sold lands, 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.

Trends in revenue from timber sales

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

The slight decline in net timber sales revenue in 2001 and 2002 was caused by an increase in certified protection costs as a direct result of increased firefighting costs on forest lands.

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

Source: M.S. 16A.125 Subd. 5(1) Transfer Certification Report, Fiscal Years 2001-2003, MN DNR, Division of Forestry

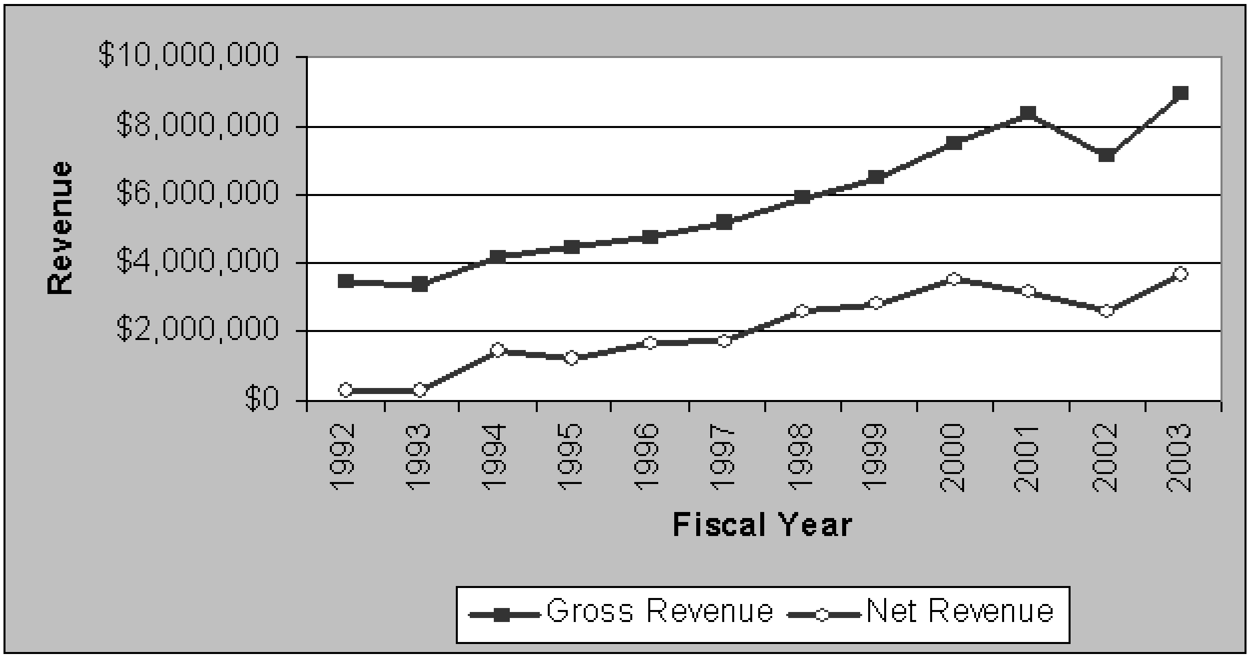


Figure 6. School trust fund income from timber sales, FY92-03.

3.5.2 Surface leasing activities (contracts[10] and campground fees).

In **FY02**, a gross total of about **$994,000** was collected on 6,802 active contracts that included some portion of trust land, and on campground fees (Tables 4, 5, 6). This included about $865,965 from the following:

Leases:	Sand and gravel, agriculture, hunting cabins, misc. commercial, government, private, lakeshore[11]
Permits:	Resource Management Access (RMA)
Easements:	Permanent and temporary easement, on trust fund land
Licenses	Water crossings, land crossings by utilities

10 Leases, licenses, easements; see tables 5 and 6.

11 In FY01, a new law changed the way revenue received from lakeshore leases was deposited; only 50% (down from 100% in FY99 and FY00) was deposited in a lakeshore leases and sales account for costs associated with the lakeshore lot exchanges, while the other 50% was deposited in the Forestry Suspense Account. Also, 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.)

Because many of the agreements involve a one-time payment in the year of issue, only some of the active contracts generated revenue in FY02. Campground fees brought in $127,924.

In **FY03**, a gross total of about **$865,194** was collected on 7,089 active contracts that included some portion of trust land, and on campground fees (Tables 4, 5, 6). As was the case in FY02, many of the active agreements generated revenue only in their year of issue. The contracts that did generate revenue brought in a total of $728,614. Campground fees brought in $136,580.

Table 5. Revenue by surface lease contract type, FY02-03.

Contract type	FY02	FY03
Easements	$84,600	$203,339
Land crossings	$7,060	$8,880
Water crossings	$106,160	$109,770
Lakeshore leases - to Lakeshore Lease Account [A] - to Forestry Suspense Account [A]	$2,820 $2,820	$2,820 $2,820
Gravel leases	$335,170	$141,750
Agriculture leases	$14,930	$12,575
Hunting cabin leases	$14,310	$13,990
Home site leases	$1,920	$1,920
Misc. commercial leases	$122,320	$91,350
Misc. government leases	$28,290	$52,320
Misc. private leases	$12,170	$6,390
Misc. leases & combined leases [B]	$128,500	$77,240
Wild rice farming [C]	$4,330	$3,280
Grant-in-Aid (GIA) and Resource Management Access (RMA) permits	$80	$0
Late fees on DNR land leases [C]	$490	$170
Total	$865,965	$728,614

[A] Deposited directly into the lakeshore lease account; income not subject to certification (see Sec. 4). (Beginning FY2001, 50% of the revenue from lakeshore leases is placed in a lakeshore leases and sales account (for costs associated with the lakeshore lot exchanges), and the other 50% is deposited in the Forestry Suspense Account.)

[B] Prior to 7/1/2002 (i.e. prior to FY02), separate codes were maintained for the different types of miscellaneous leases (i.e. commercial, government, private). Starting with FY02, new leases are in a single category, and the revenue numbers shown for “misc. leases: combined” is revenue from leases awarded since 7/1/2002.

[C] Deposited directly into the PSF. Income not subject to certification (see Section 4).

Note: Totals may not add up due to independent rounding.

Source: MAPS, FY02-03.

Table 6. Approximate number and acreage of contracts involving school trust land, FY02-03.

Contract type	FY02		FY03	
	Number of contracts	Acres	Number of contracts	Acres
Agriculture	54	1,560	65	2,470
Gravel	41	520	37	550
Home site	6	3	6	3
Hunting	59	32	53	29
Lakeshore [A]	3	3	3	3
Misc. commercial leases	72	1,050	82	945
Misc. government leases	57	1,500	51	1,490
Misc. private leases	120	470	114	460
Misc. leases, combined [B]	N/A		26	160
Easements	610	3,380	624	3,430
Land crossings	436	7,210	437	7,260
Water crossings	5,209	N/A	5,459	N/A
Subtotal	6,667	15,728	6,957	16,800
Grant-in-Aid permits	79	2,074	77	2,104
RMA permits	56	194	55	202
Subtotal	135	2,268	132	2,306
Total	6,802	17,996	7,089	19,106

[A] Due to the exchange and sale of state-owned lakeshore parcels, revenue from this type of lease was greatly reduced between FY01 and FY02. As of October 2003, there are only three remaining, which will stay in effect for the lifetime of the lessee.

[B] 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:

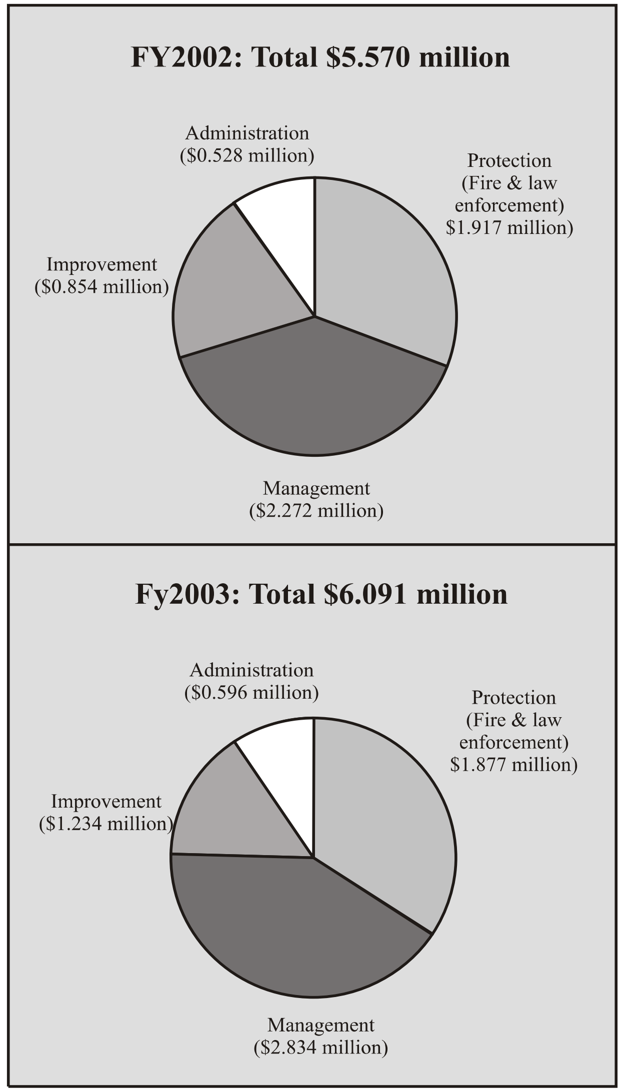
"School and other public lands of the state better adapted for production of timber than for agriculture may be set apart as state school forests, or other state forests as the legislature may provide. The legislature may also provide for their management on forestry principles. *The net revenue therefrom 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 7). 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.

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, timber sales), and on what type of land the activity took place.

Figure 7. Certified Forestry costs, FY02-03.



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.

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, 49% of all FY02 state timber sales revenues were from PSF lands, so 49% of all state timber sales costs were attributed to the PSF lands. In FY03, 48% of all state timber sales costs were attributed to the PSF lands.

4. **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 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 (see Table 4) are deposited in the State Forest Suspense Account. (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.) 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 (FY 1993 and FY 1997) 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.

Except for FY02, all the revenue from state mineral leases covering school lands has been deposited into the corpus of the PSF. Laws of Minnesota, 2001, First Special Session, Chapter 6, Article 1, Sections 1 to 3, provided that 20 percent of the annual payments received under state taconite leases covering school lands was transferred to the general fund as administration and management costs. The remaining payments made under the leases were transferred to the corpus of the PSF. The fee was only applied to iron ore and taconite leases, not the other kinds of mineral leasing activities.

This law also provided that an amount of money equal to the money transferred to the general fund was appropriated to the commissioner of natural resources 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.

The 2001 law was repealed by Laws of Minnesota 2003, First Special Session, Chapter 9, Article 5, Section 37, effective July 1, 2003. Thus, the transfer of payments received under the state taconite leases covering school lands only occurred for Fiscal Year 2002. The amount transferred to the general fund was $887,861.

5. Review of FY02-03 projects.

5.1 Forestry projects.

In FY02, the Division of Forestry offered for sale a record amount of timber from all forestry-administered lands, including School Trust Fund lands in the amount of 994,000 cords. This is the largest amount offered for sale from state-administered lands in recent decades.

This increase in timber being offered for sale was the result of a Legislative appropriation of $1.25 million meant to accelerate the management of state timber lands needing treatment. As this timber is harvested, and payments are received from loggers for the wood cut, the result will be an increase in revenues from school trust lands.

In FY03, state budget reductions eliminated the appropriation to accelerate harvests, plus an additional $1.8 million, which resulted in a reduction of the amount of wood offered in FY03 to 765,000 cords. In FY04, additional efforts will be made to implement more intermediate treatments (partial harvests of forest stands to capture mortality, improve stand health and productivity). This action will generate revenue more frequently from all lands including school trust fund lands.

5.2 Minerals projects.

5.2.1 Ferrous.

The taconite companies in Minnesota continue to face economic losses and consolidation of mine and steel plant ownerships. [12] Also, steel manufacturing is decreasing its use of taconite pellets and increasing its use of pre-reduced iron units such as scrap, direct reduced iron, and imported pig iron.

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 short term royalty reduction amendments to the state taconite leases to aid in the survival of the taconite industry. If the companies survive they will be able to mine state ore for a long time into the future.

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.

5.2.2 Non-ferrous.

Non-ferrous metallic mineral leases are issued through public auction, negotiation, and an application process 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.

One metallic minerals lease sale was held during the past two fiscal years. The sale, by public auction on July 16, 2002, offered 422,959 acres for leasing in the counties of Cook, Lake and St. Louis. Six bids were received and leases were issued covering a total of 1,165 acres, of which 1,045 are school lands. The next metallic minerals lease sale is scheduled for the summer of 2004.

During the FY02-03 biennium, a total of 12 negotiated metallic mineral leases were issued to two companies covering 4,417 acres in Aitkin County, of which 840 acres are school lands, and 1,357 acres in St. Louis County, none of which are school lands. The next metallic minerals lease sale is scheduled for the summer of 2004.

[12] In May 2003, the assets of National Steel Pellet Company were sold through bankruptcy proceedings to United States Steel Corporation. With this purchase, United States Steel is operating two mines and plants, one at Keewatin and one at Mountain Iron. This change means that almost all the taconite mining on state-leased lands will be done by United States Steel Corporation. Also in May 2003, Eveleth Mines LLC (EVTAC) declared Chapter 11 bankruptcy. A new company called United Taconite (a joint venture of Cleveland-Cliffs Inc. and Laiwu Steel Group of China), purchased the plant's assets for $3 million in cash and assumption of up to $40 million in liabilities. The plant re-opened in December 2003.

5.3 Lands projects.

FY02 On October 1, 2, and 3, 2001, the state offered 20 parcels of land for sale, of which 13 were school lands. Nine of the school land parcels sold for a total of $166,852. On June 14, 2002, the state offered nine parcels of land for sale in Lake and Cook counties. All the parcels were school lands. Six of the parcels sold, including three lakeshore parcels on White Iron Lake. The total revenue from this sale was $584,420.

FY03 A land sale was held on August 29, 2002 for one acquired fisheries parcel. Lands sales were also held on October 8, 9, and 11, 2002. Eleven of the 14 parcels were school lands. Seven of the school land parcels sold for a total of $192,850.

FY04 The department plans to hold two or more land sales in FY04. Ten of the fifteen parcels offered on October 14 and 15, 2003 were school lands. Of these 10 parcels, five were sold for a total of $106,680.

5.4 Commercial (resort) leases.

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

As necessary, survey work is done so that accurate legal descriptions and acreage can be established for the leased properties. Following this, the leased lands are appraised and the counties then offer equivalent valued land in exchange. Upon completion of the exchange, the counties are required to sell the properties to the current lessees.

Of the ten commercial leases in existence in 2000, four have been exchanged and three others are in the process of being exchanged. (Two of the completed lease exchanges are located in St. Louis County, one is in Cook County and one is in Lake County.) The DNR anticipates completing the three "in process" exchanges by March 31, 2004.

Of the three remaining commercial leases, the DNR has determined that one should remain in public ownership, and the remaining two lessees have chosen not to participate in a land exchange.

5.5 Wild rice production leases.

There are currently 558 acres of state administered land (most of it school 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 the DNR is to exchange the wild rice production lands to the counties in which they are located. The counties are then 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 (four in Beltrami County, and one each in Aitkin and Koochiching Counties) are currently targeted for exchange.

5.6 Land exchange projects involving school trust lands.

The DNR is currently working on an exchange in Lake County involving school lands in two state parks. These school lands are being exchanged for DNR-administered acquired forestry land. The purpose of the exchange is to remove the trust status from the land in the state parks and transfer it to forestry-administered property that has more potential to generate income for the PSF.

The exchange involves 420 acres of school land in Tettegouche State Park and 240 acres of school land in George Crosby Manitou State Park. These lands are being exchanged for 627 acres of equally-valued acquired forestry land located outside of the boundary and immediately west of George Crosby Manitou State Park. No state land will be disposed of by the DNR through this process. Only the classifications of the lands involved will be changed.

Upon completion of this exchange, there will still be approximately 5,702 acres of Trust Fund land located in 9 state parks and recreation areas. In future years, additional exchanges will be initiated to remove as much of this Trust Fund land as is possible from state parks. The Trust Fund classification will be transferred to other DNR administered lands that are better able to generate income for the PSF.

6. Preview of FY2004-2005 issues.

6.1 Compensating the PSF by non-revenue generating users of school trust lands.

Identifying various means of compensating the PSF continues to be a priority of the DNR. This is especially true for school lands that are managed or used in a manner that results in little or no income going to the trust. Progress was made during FY02-03 on exchanging 480 acres of trust lands in state parks (where timber harvesting was restricted) for a similar amount of land on which timber cutting is scheduled to occur. About 6,362 acres of trust lands still remain in state parks (which will decrease to 5,702 acres if the land exchange described above is completed). The DNR will be proposing a legislative bill in 2004 that will improve the ability of the department to conduct future exchanges.

No progress has been made on dealing with the approximately 51,000 acres of school trust lands that in 1991 were designated as Peatland Scientific and Natural Areas. These lands are unique in that their natural value is extremely high but their revenue-generating capability is nearly non-existent. The DNR will explore all options to compensate the PSF, including land exchanges and requesting legislative funding, directed at meeting the state's fiduciary obligation to the PSF, while at the same time ensuring that these lands are preserved in their natural condition for the knowledge and enjoyment of future generations.

Also unresolved are the PSF lands within the federally-managed Boundary Waters Canoe Area Wilderness (BWCAW). During the last biennium a legislatively commissioned study of the state owned lands located in the BWCAW was completed by the University of Minnesota Duluth (UMD). This study appraised a representative area of trust lands within the wilderness and estimated a market value of $91.7 million for all state lands. On the basis of the information generated for the study, the DNR proposed a land exchange to the U.S. Forest Service for 5,200 acres of land that was specifically appraised during the study.

The federal response to the DNR's proposed 5,200 acre land exchange was as follows: "While your initial exchange proposal is relatively small (5,000 acres), the Forest Service must consider the cumulative effect of the total project (93,000 acres and an unknown amount of federal land) in the analysis of impacts." The time and expense of evaluating the impacts of 200,000 (plus or minus) acres would likely be ill-spent if it means the resolution of only 5,200 acres of trust land. In its letter the Forest Service's Director of Lands also stated that if the state wished to dispose of its holdings in the BWCAW, the Forest Service might be interested in acquiring them.

With regard to the issue of the state selling school lands, the Legislature is on record as opposing this solution, and in 1999 passed a resolution stating that the only acceptable means of resolving the issue was through land exchange. Furthermore, many (including several legislators) have expressed a belief that the value of state lands within the BWCAW is considerably higher than the value estimated by UMD, which based its estimate on data derived using appraisal methods that follow federal appraisal guidelines. Since these guidelines substantially influence the reported land values, it is questionable whether agreement on "true" value of the lands can be reached. At this point neither a traditional land exchange nor a federal purchase of state lands within the BWCAW appears probable.

6.2 Enhancing revenue generation potential on school trust lands.

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.

The department is currently evaluating other income generating possibilities that, like reforestation, require an up-front investment, but provide rewards that will be realized through increased income in the future. The DNR will be proposing legislation that will make funds available to conduct geologic evaluations on trust land for construction aggregates. The department has conducted such evaluations on both trust and non-trust lands with positive results and short pay back periods. The expansion of these efforts is expected to increase revenue to the PSF.

6.3 Management of the PSF and income payments to public schools. [13]

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.[14]

During FY02, revenue from management of school trust lands was about $7.2 million, and about $21 million of spendable income generated by the fund was distributed to the public schools (i.e. less than 1% of the total school aid amount appropriated by the legislature). In FY03, revenue from management of school trust lands was about $11.7 million, and payments to schools totaled about $14 million.

As of June 30, 2001 (the beginning of the FY02-03 biennium) the market value of the PSF was $549 million, nearly all of which was generated from land and timber sales, land leases, and mineral taxes and royalties. Reflecting the general decline in the stock market during the fiscal year, the market value of the PSF principal dropped from $549 to $503 million during FY02, but rebounded to $527 million by the end of FY03.

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

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