MINNESOTA'S SCHOOL TRUST LANDS BIENNIAL REPORT FY14 & FY15

7.1.13 to 6.30.15

MNDNR

Minnesota Department of Natural Resources

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About This Report

Minnesota Statutes, section 84.027 subd. 18 specifies the authority and responsibility for the Minnesota Department of Natural Resources (MNDNR) to report on its management of school trust lands. The commissioner shall biannually report to the Legislative Permanent School Fund Commission and the legislature on the management of the school trust lands that shows how the commissioner has and will continue to achieve the following goals:

(1) Manage the school trust lands efficiently and in a manner that reflects the undivided loyalty to the beneficiaries consistent with the commissioner's fiduciary duties;

(2) Reduce the management expenditures of school trust lands and maximize the revenues deposited in the permanent school trust fund;

(3) Manage the sale, exchange, and commercial leasing of school trust lands, requiring returns of not less than fair market value, to maximize the revenues deposited in the permanent school trust fund and retain the value from the long-term appreciation of the school trust lands;

(4) Manage the school trust lands to maximize the long-term economic return for the permanent school trust fund while maintaining sound natural resource conservation and management principles;

(5) Optimize school trust land revenues and maximize the value of the trust consistent with the balancing of short-term and long-term interests, so that long-term benefits are not lost in an effort to maximize short-term gains; and

(6) Maintain the integrity of the trust and prevent the misapplication of its lands and its revenues.

For an overview of the history of Minnesota's school trust lands, trust land grants, information on the historic management of school trust lands, and maps for reference; there is a report named The History of Minnesota's School Trust Land Grants available as Appendix A.

Report Preparation Costs

This report provides information MNDNR collects as part of its normal course of business. The cost reported below is an estimated cost to prepare this report.

This biennial financial report cost approximately $2,500 to complete. Funds that the legislature appropriated for the school trust fund revenue enhancement program were used to complete the report.

Executive Summary

The MNDNR generates revenue on school trust lands through mineral leasing, forest products sales, real estate sales, and real estate surface contracts. The rents and royalties from iron ore/taconite leases are the primary revenue source from school trust lands, and minerals account for roughly eighty percent of historic revenues. The MNDNR deposits annual net revenues and gross revenues from state mineral leases derived from school trust land administration in the Permanent School Fund (PSF).

MNDNR management of school trust resources generated a net deposit to the PSF totaling $51.6 million in FY14. The net deposit to the PSF in FY15 was $36.8 million. The reduction in net deposit for FY15 was largely due to a decrease in iron ore/taconite mining during the fiscal year.

Table 1. Summary Net Deposit to Permanent School Fund

	FY14	**FY15**
Mineral Management	$42,883,751	$24,393,663
School Trust Land Sales	$1,893,503	$228,869
Forest and Real Estate Management – Certified	$2,203,922	$4,131,343
Real Estate Management – Non Certified	$224,475	$205,212
Minerals Management Account – Transfer In	$4,458,512	$7,874,197
Minerals Management Account – Interest	$21,237	$24,095
Total Net Deposit to PSF	**$51,685,400**	**$36,857,379**

In both FY14 and FY15, a $200,000 legislative transfer from the Forest Suspense Account to accelerate land sales, land exchanges, commercial leasing and construction aggregate development reduced the net revenue deposited into the Permanent School Fund. Additionally, in FY15 the legislature appropriated $200,000 from the General Fund to the School Trust Lands Director and Legislative Permanent School Fund Commission. Of this, only $234 in expense was incurred by the Department of Administration for the School Trust Director and $3,702 by the Legislative Permanent School Fund Commission. This General Fund appropriation is recaptured from school trust revenues credited to the Forest Suspense Account through a cost certification process.[1]

[1] MINN. STAT. SEC. 16A.125 (2015).

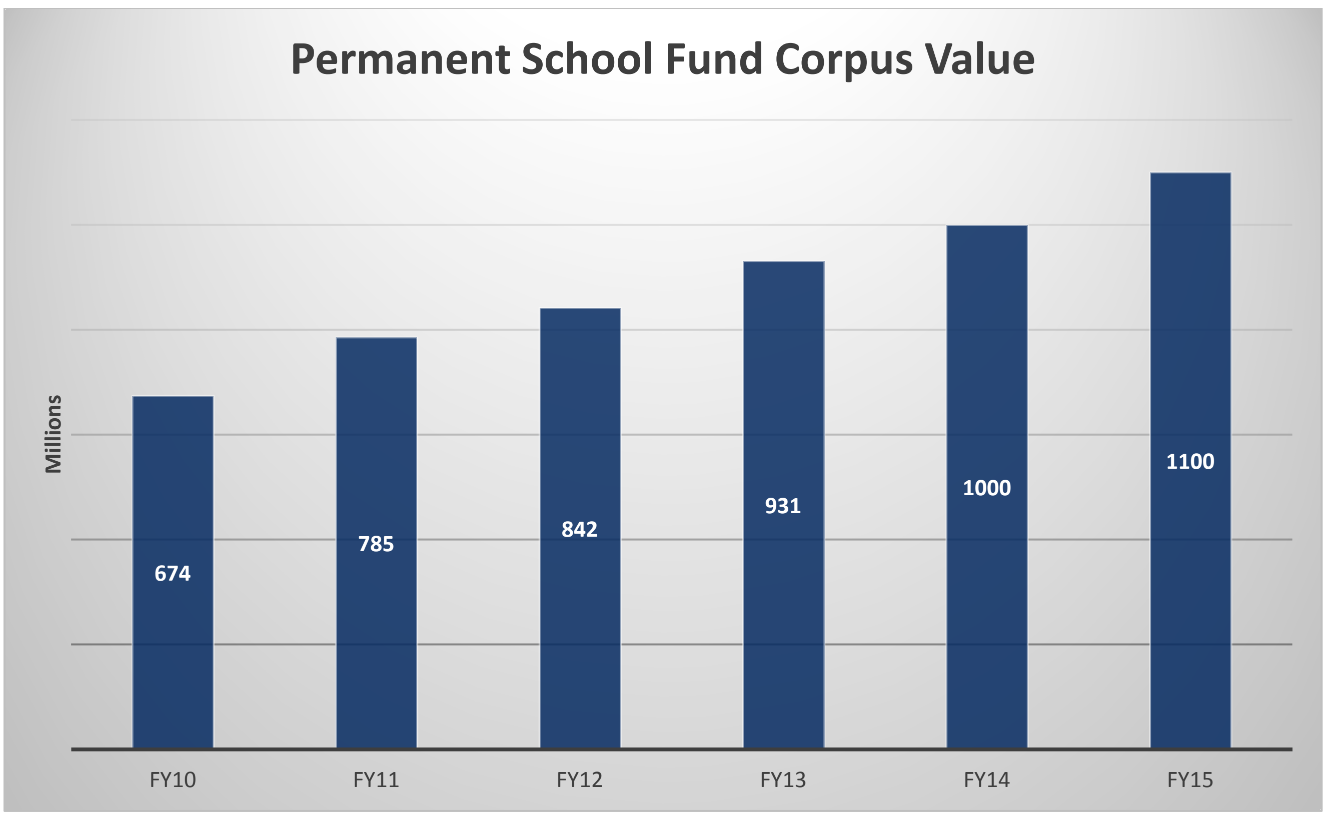
Permanent School Fund Management

In accordance with the Minnesota Constitution, the principal of the Permanent School Fund cannot be spent, and instead must remain perpetual and inviolate.[2] The commissioner of Minnesota Management & Budget (MMB) has overall management responsibilities for the PSF.[3] New investment policies enacted in 1997 allowed the State Board of Investment (SBI) to invest in a balanced portfolio of common stocks and bonds.[4] Reflecting strong stock market gains over the FY10-15 time period, the market value of the PSF principal increased from $674 million to $1.1 billion.[5] As of September 30, 2015 (first quarter FY16), the PSF value was $1.1 billion.

These financial investments generate annual income from interest and dividends, which is transferred to the School Endowment Fund.[6] The Department of Education allocates the funds semi-annually to school districts based on "the number of pupils in average daily membership during the preceding year."[7] Less than one percent of the total school aid amount appropriated annually by the legislature is contributed by the PSF.

As part of the responsibilities of the commissioner of MMB, there is an annual report that provides an overview of the PSF, reviews recent legislative changes, and provides recent transfer totals from the fund to the Minnesota Department of Education. The MMB Permanent School Fund Reports to the Legislature for 2014 and 2015 are available as Appendix B and Appendix C.

Figure 1. Permanent School Fund Corpus Value



[2] MINN. CONST. ART. XI, SEC. 8.
[3] MINN. STAT., SEC. 11A.16 SUBD. 3 (2015).
[4] MINN. STAT., SEC. 11A.24 (2015).
[5] http://mn.gov/sbi/SBI%20Funds%20Under%20Management%20Performance.html (last visited February 8, 2016).
[6] MINN. STAT., SEC. 127A.32 (2015).
[7] MINN. STAT., SEC. 127A.33. (2015)

School Trust Revenues

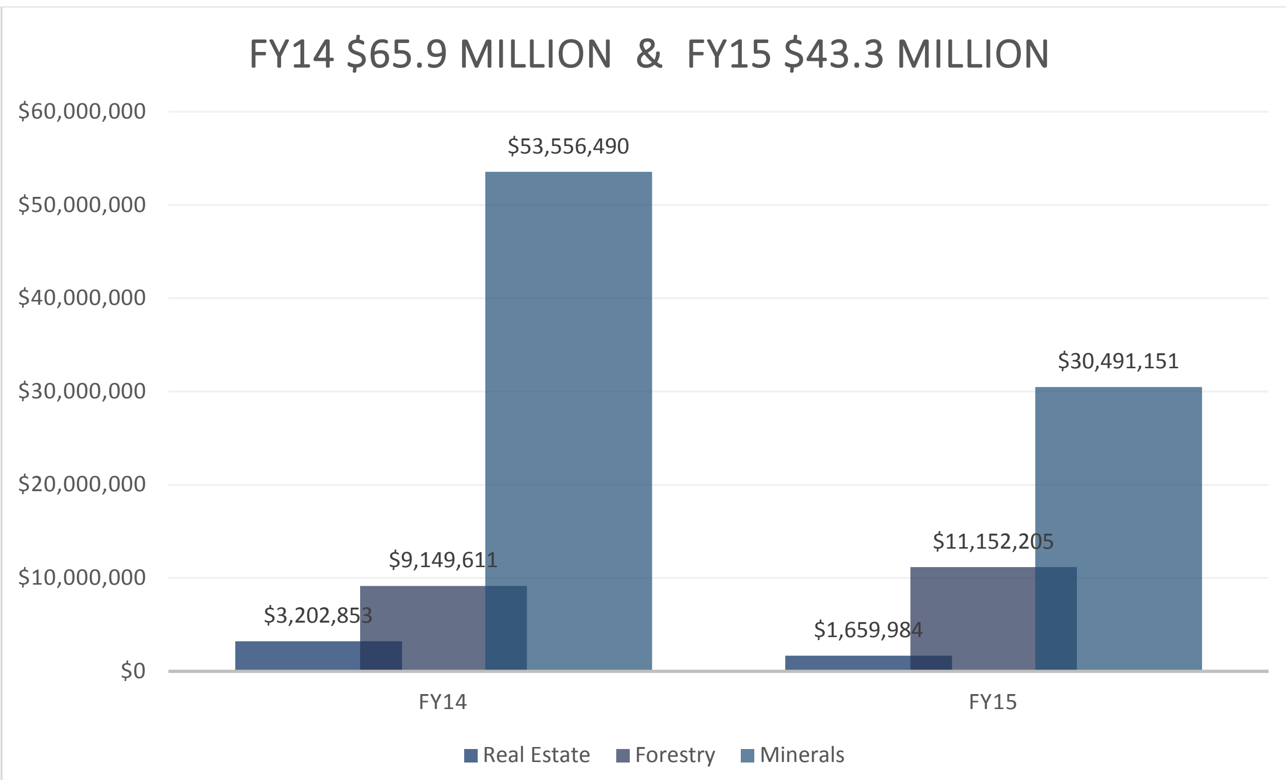
MNDNR management of school trust land generates revenue from three major categories – mineral leasing and royalty payments, forest management activities, and real estate transactions. Minnesota's school trust revenues ebb and flow with global economic demands. Between FY10 and FY13, the global economy experienced a major recession, resulting in low demand for forest products, yet a higher demand for mineral resources. During the FY14 to FY15 biennium, the global economy shifted once again resulting in low demand for school trust iron ore/taconite minerals, an increased demand for school trust forest products, and a still relatively flat real estate market.

Gross Revenues

In FY14 (7/1/13 – 6/30/14), MNDNR management activities generated $65.9 million from school trust natural resources. Mineral leasing and royalty payments accounted for $39.8 million (plus an arbitration award payment of $13.7 million for disputed mineral royalties). Forest products contributed $9.1 million and real estate contracts and school trust land sales supplied an additional $3.2 million.

In FY15 (7/1/14 – 6/30/15), MNDNR management activities generated roughly $43.3 million. Mineral leasing and royalty payments accounted for $30.4 million, forest products contributed $11.1 million, and real estate contracts and land sales supplied an additional $1.6 million.

Figure 2. FY14 & FY15 Gross Revenues



There was a year-to-year gross revenue decrease of roughly $22.6 million between FY14 and FY15 as a direct result of two one-time payments, and reduced production of school trust mineral resources. The one-time payments were the $13.7 million arbitration award and the sale of school trust land valued at $1.8 million. The arbitration award was part of revenue that should have been received and was delayed due thru dispute. It is necessary to identify these anomalies in order to accurately project future School Trust revenues. The date demonstrates mineral revenues are on declining from a high in FY13. Future revenues from real estate sales and leasing are still stabilizing after the 2008-2010 recession, while gross revenues from school trust forest resources have rebounded from lower returns.

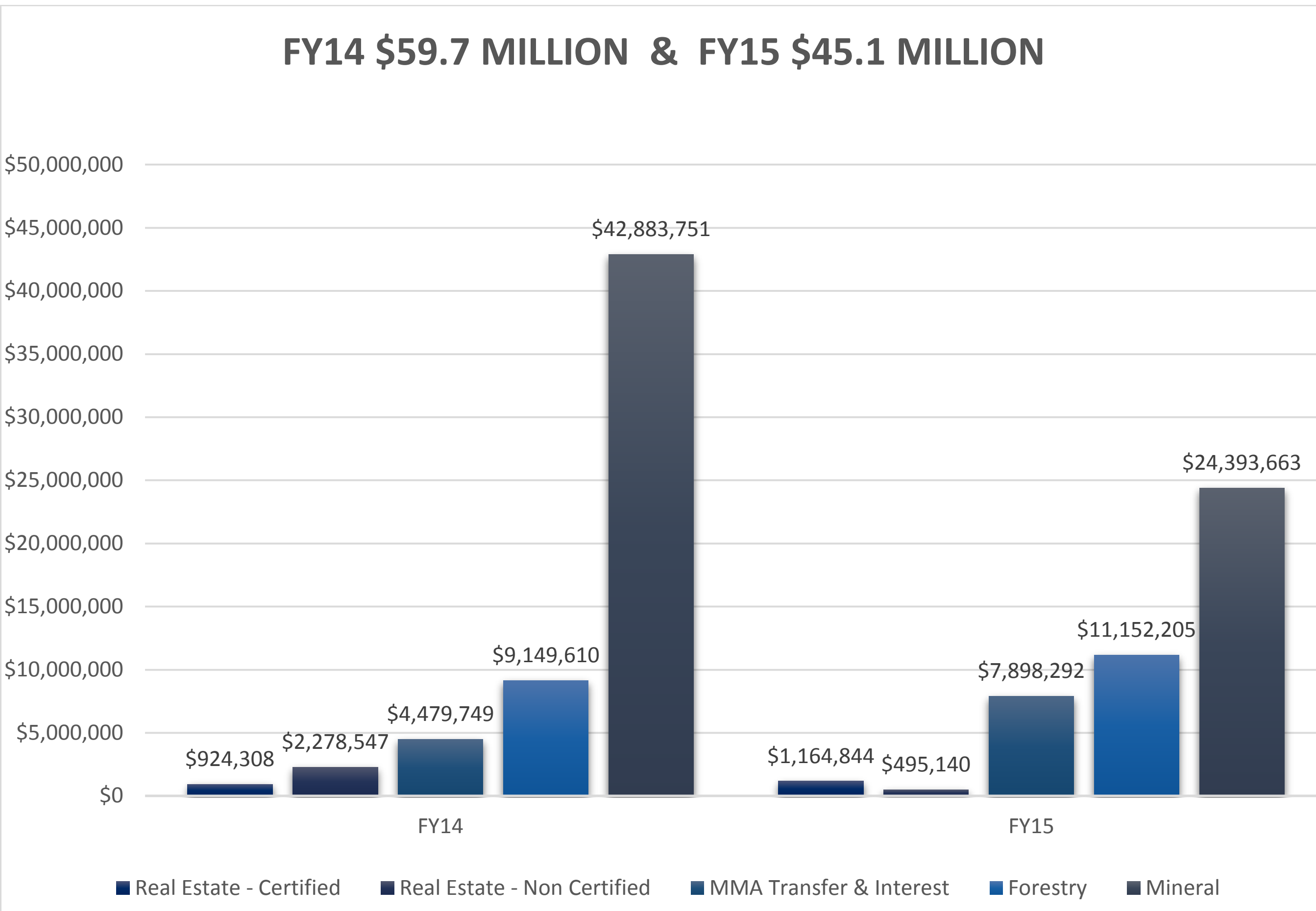
Adjusted Gross Revenues

MNDNR accounts for school trust revenues in different accounts, and under different statutory frameworks. This requires adjustments to the gross revenues realized in each fiscal year. MNDNR adjust gross revenues based on the revenue source and when it certifies its operating expenses against gross revenue. The total adjusted gross revenue is equal to the sum of gross revenue, a transfer in from the Minerals Management Account, and all real estate transactions and forest product revenues, less the twenty-percent of mineral revenue transferred to the Minerals Management Account.

In FY14 (7/1/13 – 6/30/14), the adjusted gross revenue totaled $59.7 million: $42.8 million from mineral leasing activities; $9.1 million from forest product sales and harvests; $4.4 million in transfer payments from FY13 Mineral Management Account withholdings; $2.2 million in non-certifiable real estate transaction revenue; and $924,308 in certifiable real estate transaction revenue.

In FY15 (7/1/14 – 6/30/15), the adjusted gross revenue totaled $45.1 million: $24.3 million from mineral leasing activities; $11.1 million from forest product sales and harvests; $7.8 million in transfer payments from FY14 Mineral Management Account withholdings; $495,140 in non-certifiable real estate transaction revenue; and $1.1 million in certifiable real estate transaction revenue.

Figure 3. FY14 & FY15 Adjusted Gross Revenues



Management Program Highlights

Mineral Management

The MNDNR administers the mineral rights of the school trust, university trust, and tax forfeited lands. The MNDNR, acting in its trustee capacity, manages the school trust mineral rights for the benefit of Minnesota students and local taxing authorities. The MNDNR manages the school trust mineral rights for iron ore and taconite production, non-ferrous metallic mineral exploration, dimension stone projects, industrial minerals, stockpiled ore extraction, and peat mining. Table 2 below provides a breakdown of the various sources of school trust mineral revenues.

Table 2. Adjusted Gross Receipts from Mineral Management

	FY14	FY15
Taconite and Iron Ore Rents/Royalties	$40,870,002	$23,240,537
Non-Ferrous Metallic Minerals	$365,690	$363,085
Residue Leases	$1,440,563	$767,309
Peat	$89,961	$2,512
Mineral Leases	$98,515	$1,200
Industrial Minerals	$19,020	$19,020
Total	**$42,883,751**	**$24,393,663**

Overview

In 2005, legislative changes permitted the MNDNR to receive a portion of gross revenues to fund mineral management activities. Pursuant to Minnesota Statutes, section 93.22, twenty percent of all school trust mineral receipts are deposited in the Minerals Management Account for the administration and management of the 3.5 million acres of school trust mineral interests. Eighty percent of the revenue from mineral leasing covering these school trust mineral interests is distributed to the Permanent School Fund, from which the annual net interest and dividends are distributed to the school districts throughout the state.

The Minerals Management Account was designed to create a $3 million principal that could be drawn upon in the event that future income generation drops. The $3 million level was reached in 2007. At the end of each fiscal year the amount exceeding $3 million is distributed to the Permanent School Fund, Permanent University Fund and local taxing districts in proportion to the revenue contributed to the Minerals Management Account by these three land types. Minnesota Statutes, section 93.2236 states that the MNDNR can utilize the Minerals Management Account funds, once appropriated by the legislature, for "mineral resource management and projects to enhance future mineral income and promote new mineral resource opportunities." Each year the legislature appropriates money to MNDNR from the Minerals Management Account for those activities. MNDNR does not certify its mineral management costs against the gross revenues, the legislature needs to appropriate the funding from the Minerals Management Account to MNDNR.

The legislature appropriated a total of $5,485,765 to fund MNDNR mineral management activities during FY14-15. The Legislature also appropriated $200,000 each fiscal year from the Minerals Management Account for iron ore cooperative research with a required industry match.

Table 3. School Trust Mineral Revenues Transferred

	Gross mineral lease revenue	Mineral lease revenue sent directly to the permanent school fund*	Mineral lease revenue to the Minerals Management Account (20% of revenue)			Transfer back to the permanent school fund **	Costs charged against the school trust mineral lease revenue
			Iron ore / taconite	Metallic minerals	Total***		
FY14	$53,556,490	$42,904,989	$10,217,500	$455,239	$10,672,739	$4,479,749	$2,019,069
FY15	$30,491,151	$24,417,759	$5,810,134	$287,354	$6,097,488	$7,898,292	$1,585,283

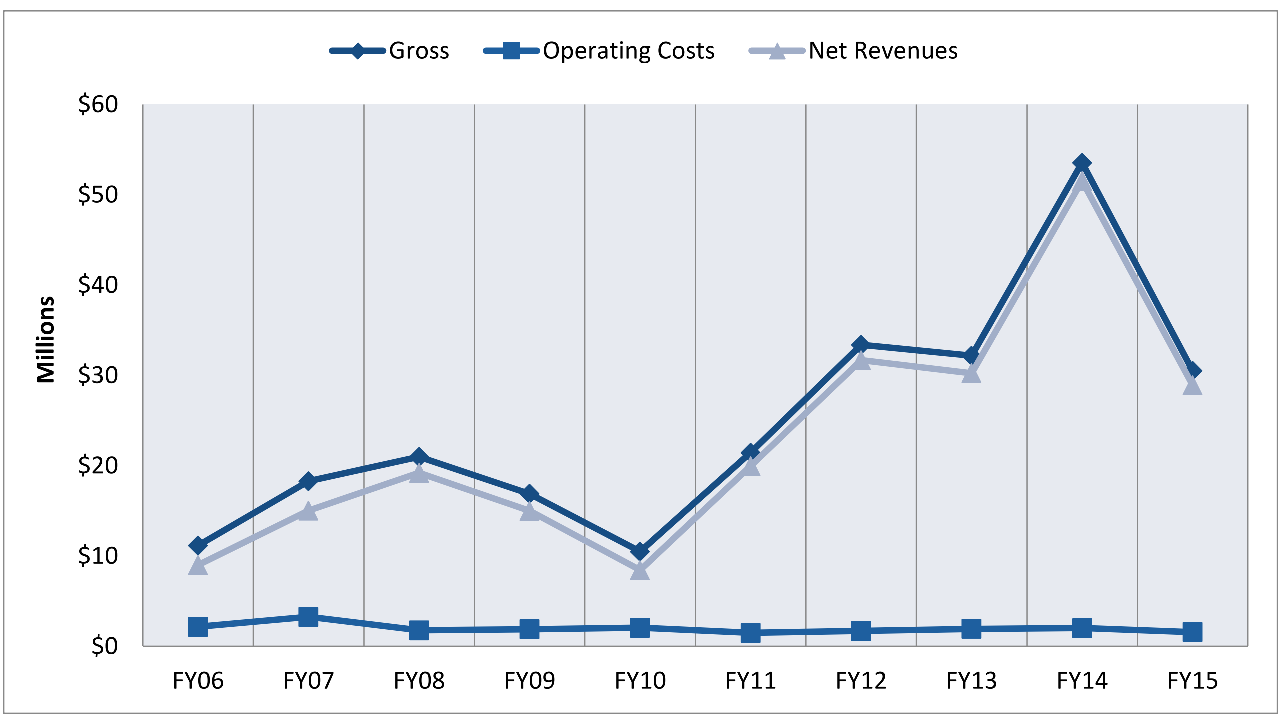
* Includes 80% of taconite/iron ore, metallic mineral, and industrial mineral lease revenues and 100% of all other mineral lease revenues.

** At the end of each FY, the amount in the Minerals Management Account exceeding $3,000,000 is returned to the school trust, university trust, and local taxing districts in proportion to the amount that each paid into the account in the previous biennium.

*** FY14 – FY15 totals include industrial minerals revenues on school trust lands.

A shown in Table 3 above, the MNDNR's operating costs associated with the school trust mineral management totaled $2.01 million, or 3.7 percent of gross mineral revenues, in FY14. The MNDNR's operating costs associated with the school trust mineral management totaled $1.5 million, or 5.1 percent of gross mineral revenues, in FY15. The MNDNR operating costs related to school trust mineral management has been approximately $2 million per fiscal year since 2008.

Figure 4. Mineral Revenues & Expenses



Activities

Iron Ore and Taconite Royalty Rate Lease Negotiations

Minnesota's iron ore industry is experiencing an economic downturn due to steel imports and a reduction of iron ore pellet prices. During FY15, U.S. Steel, Inc. temporarily idled its plant in Keewatin and laid off workers at both its Keewatin Taconite and Minntac facilities. MNDNR agreed to renegotiate the lease royalty rates to provide the company with some economic relief over a 15-month period.[8] Between its two operations, U.S. Steel currently holds 45 state taconite iron ore mining leases.

Figure 5. MNDNR Photo, © 2009.

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

If during the 15-month royalty reduction period U.S. Steel mines the expected 25 million tons of state-owned ore, this tonnage will result in total revenue for all state land of $18,750,000 using the rebased indices in the amendment and the second quarter 2015 royalty rate. Revenue without the royalty reduction amendment would have been $23,087,500. This is a reduction of $4,337,500 in revenue, or approximately 19%. MNDNR estimates that the greatest impact will be to Permanent School Fund revenues, but MNDNR cannot calculate the actual impact to the Permanent School Fund until mining occurs. The royalty reduction was enacted as a temporary agreement that would help Minnesota's iron ore compete against unfair dumping of imported steel. This allowed U.S. Steel, Minntac, the largest miner of school trust minerals to keep operating through 2015.

Mineral Encumbrance Negotiations with MNDOT

United Taconite provided notice to MNDOT to have Highway 53 re-routed in order for United Taconite to mine under the highway at the north end of the Thunderbird North Mine. MNDOT proposed numerous alignments, settling on a new Highway 53 alignment that crossed school trust land and mineral resources at the Rouchleau mine pit. The final MNDOT proposal will construct a new bridge across the mine pit and in so doing encumber school trust mineral resources.

Throughout the FY14-15 biennium, MNDOT and MNDNR collaborated on the re-route proposals, possible easement terms, a mineral resource evaluation, and a methodology to determine the school trust mineral encumbrance fee. MNDNR and MNDOT mineral evaluations determined mineral reserves totaling 19.5 million crude ore tons of taconite. MNDNR and MNDOT agreed upon a net-present valuation model resulting in MNDOT making a mineral encumbrance payment of $4.5 million. This mineral encumbrance fee was realized in FY16 when MNDNR granted the permanent easement to MNDOT. MNDNR did not convey school trust mineral resources under this new Highway 53 alignment, so it is possible that the ore may be mined sometime in the future.

[8] In the first quarter of FY16, Arcelor Mittal, Northshore, and Hibbing Taconite requested similar royalty rate relief as was granted to U.S. Steel, Inc.

Non-Ferrous Metallic Minerals Leasing

Three processes are used to issue non-ferrous metallic mineral leases in Minnesota: public auction, negotiation, and preference rights application.[9] Before the MNDNR can issue any non-ferrous metallic mineral lease, the proposed lease must be approved by the State Executive Council.[10]

During FY14, MNDNR initiated a review of its non-ferrous leasing process. Recommendations from the MNDNR process analysis were to provide more transparency earlier in the process and to offer public input opportunities prior to any offering of school trust minerals resources. MNDNR implemented these recommendations into its process including developing and launching a new lease sale website. The website includes interactive maps linked to the mining unit book, MNDNR land use screening criteria, and a public input page. Armed with a retooled comprehensive non-ferrous mineral leasing process, MNDNR began work on a public auction of non-ferrous metallic minerals that was held in November 2015 (FY16). The results of the November 2015 non-ferrous lease sale will be available in March 2016 after the Executive Council meets to determine if non-ferrous leases will be issued to the successful bidders.

Industrial Minerals

High quality dimension stone on state land leased is classified as an industrial mineral under Minnesota law.[11] It includes granite, limestone, marble, sandstone and slate. Dimension stone blocks are used in various construction applications, to make monuments, and for decorative uses once polished. It is critical for MNDNR mineral management to capitalize on economic opportunities during business cycles. However, a lack of an industrial mineral inventory is a significant hindrance to effective school trust mineral management. MNDNR partially addressed the lack of dimension stone inventory data in FY15 by completing field research in St. Louis County. MNDNR field research identified two new dimension stone discoveries.

MNDNR mineral managers recognized an immediate market opportunity from these new discoveries. MNDNR initiated its industrial mineral leasing process on both sites, and offered both at public auction in June 2015. Both sites were leased at public auction. These new industrial mineral leases likely will result in the development of two dimension stone quarries. The leases contain production guarantees totaling $150,000 per year in year 3. This provides both short-term revenue from the production guarantee as well as long-term revenue streams from royalty payments once the quarries open.

Mineral Research

MNDNR Mineral Potential Unit completed a number of activities to better understand the school trust mineral interests along with other state-owned mineral interests. During the biennium, the MNDNR completed geochemical surveys to improve MNDNR knowledge of high mineral potential areas. MNDNR geochemical surveys took place at the Tamarack copper-nickel deposit in Aitkin County and in northern St. Louis County searching for gold grains in glacial sediments. Both surveys aimed at providing additional information to encourage private exploration investment in Minnesota. Demonstrating that methods work in the specific exploration landscape conditions is one of the essential ingredients necessary to continue to attract private exploration and development investment.

MNDNR Mineral Potential Unit also was actively engaged during the biennium on the mineral evaluation of the school trust interests in the Boundary Waters Canoe Area Wilderness (BWCAW). MNDNR geologists collaborated with USDA Forest Service geologists to complete a mineral characterization determination report. The Forest Service required this report during its feasibility analysis. The Forest Service relied heavily on this report in its determination to initiate the state's proposed BWCAW land exchange, for which the decision to proceed was made in September 2014. MNDNR geologists additionally provided mineral analysis for the land exchange proposal with respect to the federal candidate parcels. The mineral analysis completed on both the school trust land and the federal candidate parcels provide insights into future decisions related to valuation and prioritization of parcels.

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[9] MINN. R. PART 6125.0500 – .0610.
[10] MINN. STAT., SEC. 93.25 SUBD. 2.
[11] MINN. R. PART 6125.8100, SUBP. 3

Forestry Management

The Minnesota Constitution establishes that school trust lands, along with other state-owned lands, can be set aside as a special class of productive forest lands and managed on forestry principles.[12] MNDNR has implemented a forest management approach that addresses all state-owned lands as one group. The 2.5 million acres of school trust lands account for 46 percent of all MNDNR managed forestry lands.

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

Overview

School Trust revenues from the forest products experienced a rebound during the FY14-15 biennium. During FY14-15, timber stumpage values increased on average 34 percent across all species, with Norway pine (red pine) experiencing a 60 percent per cord price increase from FY12-13.

In FY14, the average price received for timber sold increased to $24.42 per cord equivalent as compared to $20.59 in FY13. The average price received for timber scaled (harvested) increased to $22.64 per cord equivalent as compared to $18.61 in FY13.

In FY15, the average price received for timber sold increased to $27.65 per cord equivalent compared to $24.42 in FY14. The average price received for timber scaled (harvested) increased to $23.89 per cord equivalent as compared to $22.64 in FY14. The school trust forest product gross revenues increased by $2.0 million or 22.1percent year-over-year.

Table 4. Gross Revenue from Forest Management

	FY14	FY15
Timber Sales	$9,142,970	$11,145,915
Resource Management Access Permits	$510	$1,062
Interest Penalty	$6,076	$7,427
Total	**$9,149,611**	**$11,152,205**

Gross revenues generated from forest products management are first deposited into the Forest Suspense Account with operating costs certified against gross revenues pursuant to Minnesota Statutes, section 16A.125. Section

[12] MINN. CONST. ART. XI, SEC. 11.

16A.125 identifies four specific forest management costs that may be certified against school trust gross revenues: management, improvement, administration and forest road construction. MNDNR certifies costs annually and presents its cost certification report to the Legislative Permanent School Fund Commission. The MNDNR, Division of Forestry Transfer Certification Reports for 2014 and 2015 are available as Appendix D and Appendix E.

For FY14, forest management gross revenues totaled $10,004,387 with MNDNR certifying $7,824,939 in operating expenses on school trust lands. The result was a net deposit to the Permanent School Fund of $2,179,447 before legislative appropriations from the Forest Suspense Account. Thus, MNDNR had an operating margin of 22 percent for FY14.

For FY15, forest management gross revenues totaled $12,289,364 with MNDNR certifying $8,159,289 in operating expenses on school trust lands. The result was a net deposit to the Permanent School Fund of $4,131,342 before legislative appropriations from the Forest Suspense Account. Although MNDNR operating expenses increased by 4.3 percent from FY14; it improved its overall operating margin in FY15 to 34 percent of gross qualifying forest revenues.

Activities

Timber Management

MNDNR timber management activities in each fiscal year generate revenue across a number of fiscal years. The initial revenue is a 15 percent down payment, based on the appraised value of the permit, made at the time of sale. The remaining value of the timber permit is a required payment in the form of cash or documentary credit before the high bidder begins the harvest. The actual value of timber harvested is then invoiced on a quarterly basis until the harvesting is completed. Timber permits have a three year lifespan with ability for a one year extension, if requested.[13] MNDNR research has determined that the average length of both regular auction and intermediate auction permits is slightly less than 2 years.

Figure 6. MNDNR Photo, © 2014.

In FY14, MNDNR offered over 1 million cord equivalents, sold 836,000 cord equivalents, and harvested 851,00 cord equivalents of all species, products, and units of measure across all MNDNR managed lands. MNDNR sold 435,800 cords equivalents and harvested 389,600 cord equivalents of school trust timber resources in FY14.

In FY15, MNDNR offered 1.2 million cord equivalents, sold 942,000 cord equivalents, and harvested 887,000 cord equivalents of all species, products, and units of measure across all MNDNR managed lands. Of note, the FY15 harvest set a new record, surpassing the 2011 harvest by 2,000 cord equivalents. FY15 sold volume was helped in part by a very large timber permit (25,000 cords Super Permit) that was designed to bring logging interest and build market value to Cook County, MN that had experienced a difficult timber market. During FY15, MNDNR sold 448,800 cords equivalents and harvested 413,100 cord equivalents of school trust timber resources.

Modifications to Forest Management

In 2012, a multi-party stakeholder group met to review and provide input on the 1994 Extended Rotation Forest policy. This group was comprised of personnel from DNR divisions of Forestry, Fish & Wildlife, and Ecological & Water Resources, conservation organizations, and timber industry representatives. Stakeholder input included a request that MNDNR review and revise its rotation ages as part of the policy review. MNDNR focused its review of rotation ages on three species – aspen, black spruce and Norway (red) pine. The result was a recommendation to maintain

[13] MINN. STAT., SEC. 90.193.

aspen and black spruce at current rotation ages and reduce the rotation age for red pine plantations from 100 years to 60-70 years. MNDNR's forest economist defined these rotation ages as the age class that maximizes the financial returns of state investments in forest management, or, the economic rotation age.

In April 2014, MNDNR implemented the policy change only on school trust lands after identifying approximately 2,400 acres of school trust red pine plantations at or above the economic rotation age. MNDNR instructed its timber sale staff to do field examinations on up to 835 acres annually over a three year period for final harvest. Final harvest, or clear cutting, of red pine plantations is necessary to ensure the vitality of new seedlings. There is a major risk of infecting seedlings with diplodia (a common fungal disease of stressed conifers) when mature pines are left in the plantation. MNDNR intends to reforest each red pine plantation on school trust land after final harvest. Reforestation plans will depend on what will produce maximum long-term revenue for the school trust and will consider what species will best thrive in particular locations. As an example, an existing plantation could be converted to a mixed hardwood stand based on soil characteristics and reforestation costs.

MNDNR also gave its timber sale staff flexibility to defer final harvest of school trust red pine plantations to age 100 if certain situations warranted a deviation. Direction to staff identified deferments that were acceptable, and encouraged, if a local specialty market existed (such as utility poles or home building logs), the stand was in a visibly sensitive corridor, the stand had not reached the DNR targeted economic diameter, or the stand was located in a high conservation value forest area or had been identified to be managed for older, natural forest characteristics through MNDNR subsection forest management planning.

In addition to the 835 acres identified in April 2014, MNDNR offered for sale in June 2014 258 acres of school trust red pine plantation timber. These 258 acres included 8,532 cords of red pine on 12 timber harvest permits. The total sold value was $649,688, or $73.64 average per cord, with a high value of $98.56 for a high quality stand that included trees that could be used for utility poles.

MNDNR continued its success with red pine plantation sales by offering an additional 344 acres of school trust red pine plantation during FY15. These 344 acres included 12,570 cords of red pine on 11 timber harvest permits. The total sold value was $1,050,181, or $85.72 average per cord, with a high value of $102.41 for a high quality stand where 90% of the volume of trees could be used for saw timber.

Real Estate Management

As part of its real estate management activities, the MNDNR enters into various real estate contracts on school trust lands. The MNDNR generates revenue from school trust lands through lease contracts,[14] easements,[15] and licenses.[16] Additional revenue is generated through annual public auctions of school trust lands.[17] Also, the MNDNR as a trustee enters into land exchanges[18] that reposition the school trust lands to consolidate ownership, improve management, or to take advantage of future revenue potential.

Overview

Revenues deposited in the Forest Suspense Account from forest management subject to forestry cost certification per Section 16A.125 are not limited to timber sales and mineral resource permits. Revenues are also generated from real estate transactions (aggregates, agriculture, hunting cabins, miscellaneous commercial and government, and lakeshore), permits (resource management access, and grant-in-aid), easements (permanent and temporary easements - primarily roads), and utility licenses (land crossings). Water crossing licenses,[19] wild rice farming leases and the sale of standing timber are not subject to forestry cost certification under section 16A.125.

In addition, for FY14-15, the legislature appropriated $200,000 each fiscal year from the Forest Suspense Account to accelerate leasing, land sales and land exchanges, and for the identification, evaluation and leasing of aggregate resources.[20]

Activities

Strategic Land Asset Management

MNDNR developed a standard decision making framework to guide its management activities. The framework, known as the Strategic Land Asset Management (SLAM) program, seeks to optimize the use of MNDNR administered lands within the context of all Minnesota's public lands and focuses on collaboration between the MNDNR, school trust land director, and other public land managers.

The SLAM program framework is an interdisciplinary approach to upgrading MNDNR's land holdings through strategic acquisition, sales and exchange. Staff members are directed to evaluate land decisions based on six goals, three of which relate directly to improving school trust land status. They are 1) meet our fiduciary responsibilities on school trust lands; 2) consolidate state land; and 3) improve access to state land.

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[14] Minn. Stat., secs. 84.153 (residences); 89.17 (forest use); and 92.50 (miscellaneous).
[15] Minn. Stat., sec. 84.63.
[16] Minn. Stat., sec. 84.415.
[17] Minn. Stat., sec. 92.12.
[18] Minn. Stat., sec. 94.343.
[19] Laws of Minnesota 2009, Chapter 37, Article 1, section 12 amending Minnesota Statutes, section 84.415 to require licenses and permits for the use of the beds of public waters be credited directly to the Permanent School Fund.
[20] *See* Laws of Minnesota 2011, First Special Session, Chapter 2, Art 1, Sec. 4, subd. 2.

By implementing these three strategies, the DNR aims to fulfill its fiduciary obligations to secure long-term revenue generation through the sound management of school trust lands.

Land Contracts

During FY14-15, the MNDNR entered into 146 real estate contracts involving 1,650 acres of school trust land. Table 5 below provides a breakdown of the FY14-15 contracts and school trust acres.

Table 5. Real Estate Contracts

	Number	Acres
Easements	5	20
Utility Licenses – Land Crossings	22	90
Leases – Agricultural	24	860
Leases – Earth Material (Gravel)	19	170
Leases – Miscellaneous	67	510
Leases – Communication Tower	2	Not available
Leases – Grant-In-Aid Permits	7	Not applicable

Land Sales

Minnesota Statutes, section 92.12 requires that the MNDNR hold frequent sales of school trust lands and other state-owned lands. Revenue generated from the public auction sale[21] of school trust lands is not subject to forest cost certification under Minnesota Statutes, section 16A.125.

In order to comply with the constitutional and statutory requirements to offer school trust land at public auction, the MNDNR incurs operating expenses for professional services related to survey, appraisal, legal, advertising and other fees on behalf of the school trust.[22] The minimum bid price for school trust lands offered at public auction, therefore, includes the appraised value and some of MNDNR operating expenses. MNDNR does not pass all staff costs along to the bidder and those costs are paid out of other funding; usually general fund dollars. When a school trust parcel sells at public auction, pursuant to Minnesota Statutes, section 94.16, the MNDNR deposits the successful high bid amount into the Permanent School Fund less operating expenses. Given that school trust land can only be sold at public auction, MNDNR incurs unreimbursed expenses for all unsold parcels. MNDNR incurs additional costs to reoffer unsold school trust land at subsequent public auctions. It is recommended that funding for land sales and related transaction costs should be supported from the school trust.

Figure 7. MNDNR Photo, © 2013

In FY14, the MNDNR administered one public auction sale in July 2013 offering twenty-one school trust parcels totaling 841 acres. Ten parcels were sold, for total revenue of $1,877,345. Of particular interest was the offering of a

[21] MINN. CONST. ART. XI, SEC. 8 REQUIRING THAT SCHOOL TRUST LANDS BE SOLD ONLY AT PUBLIC AUCTION.
[22] MINN. STAT., SEC. 94.16.

65-acre school trust parcel in Lake County that MNDNR refers to as the Little Marais parcel. It is located on the north shore of Lake Superior and had not been actively managed. The Little Marais parcel, however, was identified by MNDNR school trust inventory as a high-value real estate parcel. MNDNR analyzed the parcel for its various natural resource benefits and appraised it under three different scenarios to ensure the school trust received maximum value. The MNDNR offered the parcel at public auction for a minimum bid price of $800,000. The auctioneer's hammer price was $1,200,000.

In FY15, the MNDNR administered two public auctions of school trust and other lands in August 2014 and October 2014, offering 38 school trust parcels totaling 729 acres. Of the school trust parcels offered, 216.1 acres were sold for a total revenue of $279,415.

Since 1999 the MNDNR no longer offers school trust land for sale by certificate of sale, which provided for installment payments over a 10 or 20 year period. Therefore, the amount of revenue generated by older sales will continue to decrease as the final certificates of sale are paid. Current public auction sale terms require a 10 percent down payment at the time of the auction with the remaining 90 percent due within 90 days of the auction.

Land Exchanges

During FY14, MNDNR did not complete school trust land exchanges. However, MNDNR made significant progress on land exchanges involving school trust lands through its SLAM program.

During FY15, the MNDNR completed two land exchanges involving school trust lands. The first SLAM program land exchange received Land Exchange Board approval in June 2015. The land exchange was a partnership between the school trust and Lake County. It involved 1,822 acres of school trust land and 1,910 acres of county tax-forfeited land, both valued equally at $1,140,000. This land exchange consolidated ownerships of both parties with a goal of reducing future management expenses.

The Land Exchange Board approved the Sax-Zim Bog exchange in September 2014. This was a unique land exchange involving multiple partners that brought about numerous benefits for Minnesota. The school trust upgraded its degraded wetland land base at Sax-Zim for productive timberlands in northern St. Louis County. The Sax-Zim bog wetland is being restored by a private company, and after restoration is complete wetland banking credits will be available for Minnesota industries. Finally, the Sax-Zim bog will remain its natural state as an Audubon Society identified Important Birding Area. The land exchange project involved 12,658 acres of school trust land being exchanged for 5,715 acres of industrial timberland. The appraised value of the school trust land was $6,136,800 and the private land value was $6,140,100. The exchange partner waived the $3,300 difference in value.

Recreational Use

The MNDNR manages forest campgrounds located on school trust lands. In FY14, total revenue generated from campground fees was $154,943. In FY15, total revenue generated from campground fees was $177,528. The revenue generated from forest campgrounds is not subject to forest cost certification under Minnesota Statutes, section 16A.125. Thus, the MNDNR pays the costs of operating forest campgrounds on school trust lands from other sources. These operational costs should be supported from the school trust. All gross revenues from forest campground are deposited in the Forest Suspense Account prior to being deposited into the Permanent School Fund.

MNDNR also began development of a new recreational lease in FY14 and FY15 for a mountain bike destination site. In collaboration with a local mountain biking club and local government officials, MNDNR Parks and Trails staff identified an ideal site for a new mountain bike trail in Cohasset. The new trail will repurpose an old iron ore tailings site for off-road biking. MNDNR anticipates executing the lease and opening the Tioga Pit Mountain Bike trail in calendar year 2016. This new recreation lease opportunity demonstrates a modern view by MNDNR to explore all revenue possibilities for school trust land management.

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

Appendices

A. **History of Minnesota's School Trust Land Grants**

B. **Minnesota Management & Budget, Permanent School Fund Report, January 2014**

C. **Minnesota Management & Budget, Permanent School Fund Report, January 2015**

D. **Minnesota Department of Natural Resources, Division of Forestry Transfer Certification Report, 2014**

E. **Minnesota Department of Natural Resources, Division of Forestry Transfer Certification Report, 2015**

Disclaimer

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For more information contact:

DNR Information Center
500 Lafayette Road
St. Paul, MN 55155-4040
TTY 1-800-657-3929
TTY (651) 296-5484 (metro area)

1-888-MINNDNR (646-6367)
(651) 296-6157 (metro area)

www.dnr.state.mn.us

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