

2013

MN Dept Of Natural Resources

Division of Forestry

[M.S. 16A.125 TRANSFER CERTIFICATION REPORT]

The contents of this report identify costs certified against trust lands and how the certified costs and net revenues from trust lands are distributed

Contents include:

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Executive summary

This cost certification report provides details on timber revenue and forest management costs for trust fund lands in fiscal year 2013. As defined by M.S. 16A.125, Forest management costs are based on five general activities: Fire Protection, Forest Roads, Management, Improvement and Administration. DNR Division of Forestry tracks its operating costs by administrative area for accuracy and transparency. With accurate costs for each administrative area, DNR can apply the costs for protection, forest roads, management, improvement and administration against gross revenues from each administrative area.

In FY13, the Permanent School and University Funds will receive a revenue transfer from the Forest Suspense account of \$153,517. The reduction in revenue transfer from past years is due to four major factors negatively impacting net revenues from school trust timber resources. The first factor is the continued economic downturn in Minnesota's timber industry. The second and third factors are the result of wildfire events and severe blowdown events during the FY12-13 biennium. The fourth factor is an increase in DNR central support services.

Trust land forest management revenue was \$7,792,438 in FY13. This is a 9% percent decline from FY12 gross revenues of \$8,589,321. The decrease in revenues is directly attributable to mill closings and the lingering effects of severe weather. In particular, the Verso mill closure reduced the demand for forest products. The July 2011 windstorm in Pine County and July 2012 windstorm in northern Minnesota led to salvage timber operations with reduced timber values and volumes.

Fire protection costs were elevated by higher than average spring fire costs and significantly higher costs during the unusually prolonged and difficult fall 2012 wildland fire season in northwestern Minnesota. Costs rose from \$1,518,024 in FY 2012 to \$2,344,369 in FY 2013. This is a 54% increase in fire costs.

DNR Support Services fees increased due to payment of real estate costs that were previously subsidized by general funds dollars at the department level. Those costs were reallocated proportionally to each division, resulting in an increase of forestry administrative costs from \$ 1,274,596 in FY 2012 to \$1,602,783 in FY 2013.

There was a decrease in forest management costs (from \$4,242,532 in FY 2012 to \$3,827,542 in FY 2013), due to increases in efficiency of operations such as a concentrated timber marketing project in northeastern Minnesota.

Under M.S. 16A.125, subd. 5d, this report certifies the transfer of funds from the forest suspense account to the Forest Management Investment Account (FMIA) (\$4,177,618) for management, improvement and roads costs, and to the General Fund (\$3,551,298) for protection and administration costs; with \$153,517 being transferred to the trust (\$83,040 to the School Trust and \$70,478 to the University Trust). Costs are tracked by administrative area for accuracy and transparency.

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M.S.16A.125 Transfer Certification Process

Minnesota Statute 16A.125, Subd. 5 direct which costs are certified against trust fund lands and how the certified costs and net revenues from trust fund lands are distributed. Only those costs paid from the General Fund and Forest Management Investment Fund are included in cost certification. Costs charged to dedicated funds and federal funds are excluded from the cost certification process. In addition, only revenues derived from Forestry activities are included in the process. Non-forestry revenues, such as mineral royalties are excluded.

MS16A.125, Subd 5 states:

Subd. 5. Forest trust lands.

(a) The term "state forest trust fund lands" as used in this subdivision, means public land in trust under the Constitution set apart as "forest lands under the authority of the commissioner" of natural resources as defined by section [89.001, subdivision 13](#).

(b) The commissioner of management and budget shall credit the revenue from the forest trust fund lands to the forest suspense account. The account must specify the trust funds interested in the lands and the respective receipts of the lands.

(c) After a fiscal year, the commissioner of management and budget shall certify the total costs incurred for forestry during that year under appropriations for the protection, improvement, administration, and management of state forest trust fund lands and construction and improvement of forest roads to enhance the forest value of the lands. The certificate must specify the trust funds interested in the lands. The commissioner of natural resources shall supply the commissioner of management and budget with the information needed for the certificate.

(d) After a fiscal year, the commissioner shall distribute the receipts credited to the suspense account during that fiscal year as follows:

(1) the amount of the certified costs incurred by the state for forest management, forest improvement, and road improvement during the fiscal year shall be transferred to the forest management investment account established under section [89.039](#);

(2) the balance of the certified costs incurred by the state during the fiscal year shall be transferred to the general fund; and

(3) the balance of the receipts shall then be returned prorated to the trust funds in proportion to their respective interests in the lands which produced the receipts.

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The Division of Forestry identifies hours paid and dollars expended using a set of cost codes. The cost codes identify charges based on a specific activity (e.g. fire suppression, forest inventory, etc.) that created the expenditure. These activities are grouped into 5 main categories; protection, improvement, roads, management, and administration. Once costs are determined, they are allocated between trust and non-trust by acreage in each administrative area. Trust costs are prorated on a per acre basis between school and university. Total state acres subject to forest management activities are ~5.4 million. Of this amount, ~2.4 million acres is attributable to trust fund lands. The certification process only applies to activities that generate forestry related net revenues. Activities such as recreation and private land management are excluded from the process.

Five types of activities have an allocation process.

1. Fire Protection (\$2,344,369): The DNR protects 22.8 million acres against wildfires. The cost of protecting Trust lands against wildfire is determined by multiplying trust land acres on a cost per acre basis. Prevention and pre-suppression costs are not specific to any land base, but provide general protection to all lands equally, so costs are allocated on a statewide acreage percentage. Suppression costs however, can be tracked to a specific administrative area so costs are allocated on an area acreage percentage basis.

Minnesota Laws of 2012, Chapter 249, Section 3, Subd.5c amended 16A.125 to remove protection from certifiable costs effective July 1, 2013. This will be the final certification transfer report that will include protection costs.

2. Forest Roads (\$26,314): State forest roads provide access to some trust lands. Road costs are tracked by administrative area and allocated to the trust based on the percentage of trust land served by that area's roads.
3. Management (\$3,827,542): Management costs are divided into two main categories; forest management and timber sales. Forest management costs which is the cost of maintaining forests for future revenue, including activities like inventory and insect and disease management. Timber activities consist of timber sales preparation and administration. These timber activities can be directly tied to the revenue generated on trust lands. Management costs are tracked by administrative area and allocated by area based on the percentage of trust land managed in each area. On a statewide basis, the trust allocation averages 44 percent.
4. Forest Improvement (\$789,431): Forest improvement activities include site preparation and stand improvement that establish and improve forests for future revenue. Improvement costs are tracked by administrative area and allocated by area based on the

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percentage of trust land in each area. On a statewide basis, the trust allocation averages 46 percent.

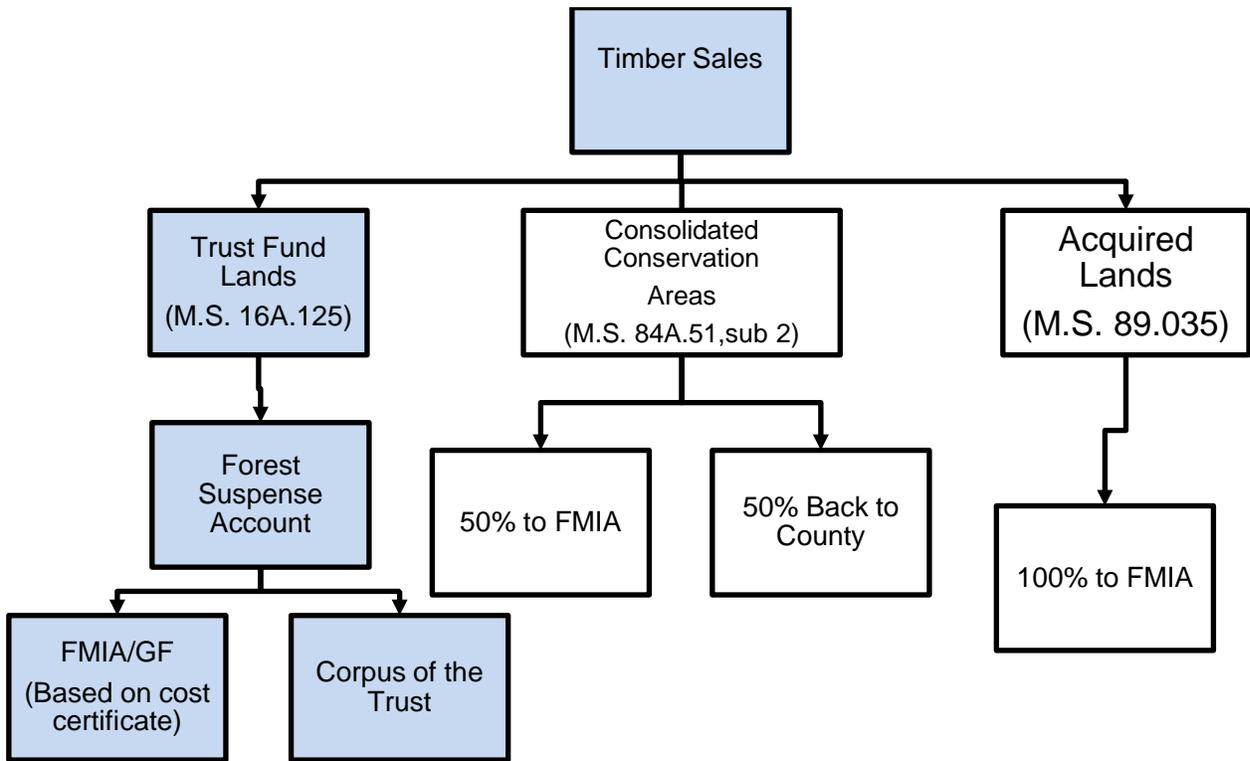
5. Administration (\$1,602,783): Administrative costs are direct and necessary costs related to the support of staff that generates revenue. Administrative costs are tracked by administrative area and allocated by area based on the percentage of trust land in each area.

General Operations: In addition, general operations costs are “the cost of doing business”, the record keeping and other activities that support day-to-day operations. Support services, such as bill paying, hiring, training, and personnel management allow the certifiable activities above to be performed. Costs for support services, however, are difficult to tie to any specific activity. Therefore, general operations costs are prorated back to activities based on the percent of expenditures in each activity (i.e.: management, improvement, roads, and administration). Thus, if maintaining forest roads accounts for 5 percent of all expenditures, 5 percent of general operations costs are included in the cost of maintaining forest roads. Fire Protection is excluded from this calculation because these activities are charged directly to fire.

Finally, the trust land certification process was reviewed in FY1998 by the Office of Legislative Auditor (OLA). In the final reports issued by the OLA, the methods and process used were found “to be reasonable”. Directives and suggestions for change and improvement have been implemented.

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The purpose of this graph is to identify how Timber Sales revenue on Trust Lands flows through the suspense account and to provide a historical summary on the account. Per M.S. 16A.125, Subd 5., certified costs for administration and protection are transferred to the general fund. Costs for management, improvement and roads are transferred to FMIA. The balance is transferred to the corpus of the trust.

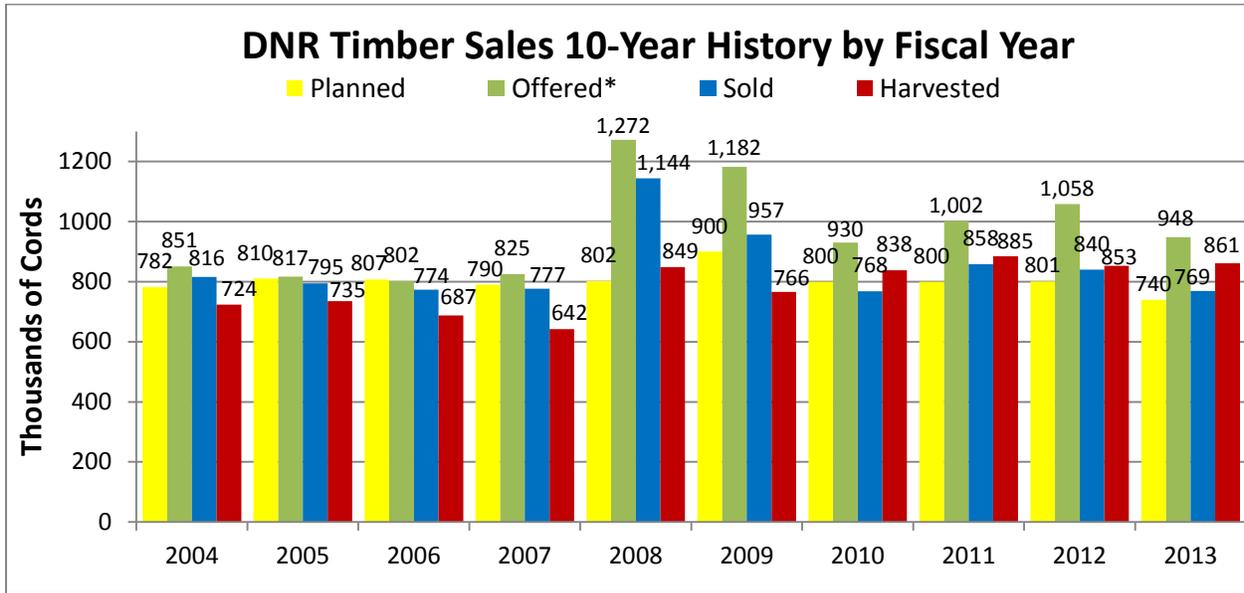


	2009	2010	2011	2012	2013	5 Yr Avg
Total Timber Revenue	19,561	18,946	19,564	17,114	15,931	18,223
Revenue on Trust Lands	11,430	9,713	10,060	8,589	7,792	9,517
Cost Transfer to GF	4,067	3,793	3,026	2,793	3,551	3,446
Cost Transfer to FMIA	7,110	4,926	4,934	4,931	4,178	5,216
Transfer to Trust	231	980	2403	1026	153	958

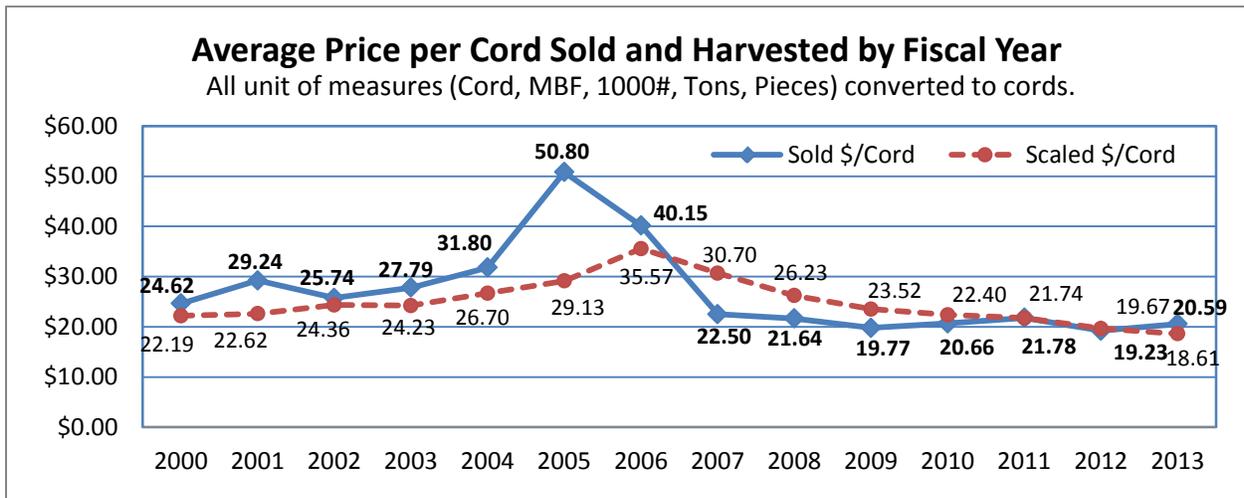
M.S.16A.125, Subd.5(d)-Costs certified in FY13 are actually transferred in FY14.

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The purpose of the top graph is to show the historical trend for cords planned, offered, sold and harvested. The bottom graph shows the historical trend of the average price sold per cord and the average price received for cords scaled (harvested).



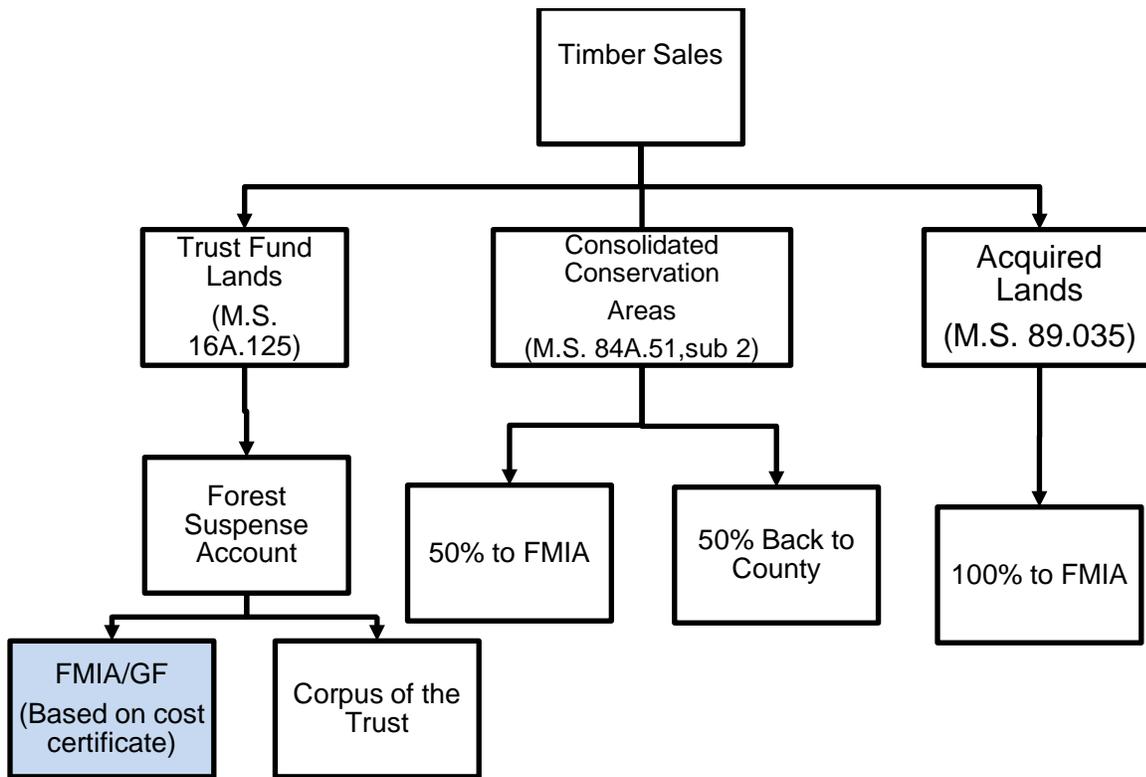
*The large increase in volume offered and sold in FY2008-9 was due to the re-offering of sales forfeited in 2007. The 885,000 cord equivalents harvested in FY2011 was a record harvest level from state lands.



Due to the timber market collapse that began in August 2006, the average price per cord sold for state timber dropped 60% in FY2009 compared to the value received in FY2005. Many of the sales that were sold in FY2005-06 for \$40+ per cord were forfeited and then resold in subsequent years at a lower price. Due to the harvest of windstorm-damaged salvage timber sales in FY2012-13, the average price/cord of timber harvested (scaled) decreased.

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The purpose of this chart is to identify a historical perspective on certified costs.



Forestry Certified Costs (in thousands) FY 2008-2012						
	2009	2010	2011	2012	2013	5 Yr Avg
Protection	1,844	2,000	1,169	1,518	2,344	2,064
Forest Management	6,010	4,100	4,361	4,242	3,828	5,263
Forest Improvement	1,026	771	557	664	789	887
Administration	2,223	1,793	1,857	1,275	1,603	2,062
Forest Roads	74	55	16	24	26	46
Total	11,177	8,719	7,960	7,723	8,590*	10,323

M.S.16A.125, Subd 5(d)

Protection & Administration Costs are transferred to the General Fund.

Forest Management, Forest Improvement and Forest Road Costs are transferred to FMIA.

* Actual transfer is \$7,728,916 due to costs exceeding revenue.