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# **The Permanent School Fund - Background and Issues**

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*This paper provides background information and examines a number of issues involving the Permanent School Fund.*

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## Introduction

The Permanent School Fund (PSF) is a trust that consists of two parts, lands granted to the state by the federal government and the principal of the fund generated by those lands. A variety of lands have been consolidated into the PSF including school trust, swamp, and internal improvement lands. These lands are managed by the Department of Natural Resources (DNR). The principal or corpus of the trust includes cash and investments generated from land sales, mining royalties, timber sales, lakeshore and other leases, gifts to the fund and any other sources. The State Board of Investment (SBI) is responsible for investment of the principal.

A Permanent University Fund also exists separate from the PSF.

## Source of Land

Land was placed in a School Trust when Minnesota became a state. Lands in the PSF trust came from three major sources (Table 1).<sup>1</sup>

**Table 1: Federal Land Grants to the State of Minnesota**

<b>Acres</b>	<b>Source of Acres</b>
2,995,628	School lands granted to the state in the Enabling (Statehood) Act of 1857. This land consisted of sections 16 and 36 of most townships and lands selected in lieu of those sections where sections 16 or 36 were no longer available.
4,770,000	Swamp or overflowed lands granted to the state in 1860. Most of this acreage was sold or granted away but the remaining 1,560,000 acres were combined with the PSF trust lands by a 1962 constitutional amendment.
500,000	Acres granted to the state as internal improvement lands in 1866. All but 6,677 acres of this land was sold and a 1974 constitutional amendment transferred all remaining land, cash, and investments of the internal improvement land fund to the PSF.
<b>8,265,628</b>	<b>Total Acres Granted to Minnesota</b>

In the late 1800s it was state policy to convey these lands into private ownership as quickly as possible<sup>2</sup>. Therefore, many of these lands were sold in the years following statehood, mostly in the good farming soil regions of the state. Any PSF land sold must be done so at a public auction<sup>3</sup>.

Beginning in the early 1900s, the policy of selling trust fund land was modified and various types of public land were withdrawn from sale. The state policy started to shift toward an awareness that public management of the land was in the best long-term interest of the school trust fund. Of the 8.3 million acres of lands granted to the state, 2.5 million acres remain in the PSF. Most of these remaining lands are in the northern part of the state; over 85 percent is located in Koochiching, St. Louis, Itasca, Lake, Cass, Aitkin and Cook counties. Of the 2.5 million acres, 1.8 million acres are in DNR management units as follows

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<sup>1</sup>March 1983, Permanent School Fund Management Report, DNR.

<sup>2</sup>Ibid.

<sup>3</sup>Minnesota Constitution Article XI, Section 8.

(the numbers for management areas will add to a number greater than the total because some land parcels are in more than one management area):

**Table 2: PSF Land in DNR Management Units <sup>4</sup>**

<b>DNR Management Unit</b>	<b>Acres</b>
State Forests including Campgrounds	1,737,123
Wildlife Management Areas	85,681
Scientific & Natural Areas	51,000
State Parks	5,745
Riverways	756
Water Access	2,880

In 1997 there were about 150,000 acres of PSF land in management units that prohibited the generation of revenue for the PSF including 93,260 acres in the Boundary Waters Canoe Area (BWCA).<sup>5</sup> Table 3 on the next page shows the total acres of land in non-revenue earning sites.

An additional 706,800 acres are managed by DNR outside established management areas. These acres are primarily forestry lands but also include mineral, agricultural and lakeshore lands and other smaller categories. In addition to the 2.5 million acres of land, the PSF also includes the severed mineral rights only for another almost 1 million acres.<sup>6</sup>

### **Management of PSF Land**

The DNR's goal for management of PSF lands is "to secure the maximum long-term economic return from the school trust land consistent with sound natural resource conservation and management principles and specific policy guidance as provided in state law."<sup>7</sup>

A constitutional amendment passed in 1984 allows PSF land to be exchanged for other state lands. Prior to that, PSF land could only be exchanged for federal or private land. The goal of land exchanges is to remove PSF land from management areas where it had no potential of earning revenue for the PSF. The most obvious example of this was PSF land in state parks. When some state parks were established, the PSF land was considered to be state land and included in the park with no reimbursement to the PSF.

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<sup>4</sup>February 1998, Legislative Audit Report on School Trust Land.

<sup>5</sup> Ibid.

<sup>6</sup>Data from March 1983, Permanent School Fund Management Report, DNR and updated by DNR in October, 1996.

<sup>7</sup>March 1983, Permanent School Fund Management Report, DNR.

**Table 3: School Trust Fund Land in Uses That Prohibit the Generation of Revenue, 1997 <sup>8</sup>**

<b>Use</b>	<b>Estimated Acres</b>
State Parks	5,060
Peatland Scientific and Natural Areas	51,000
Boundary Waters Canoe Area Wilderness	93,260
<b>Estimated Total:</b>	<b>149,320</b>

During the early 1990s, DNR implemented land exchange packages that resulted in 5,400 acres of PSF land in state parks being exchanged for state land outside parks. These exchanges removed about 50 percent of the PSF land from state parks. After these exchanges were completed, PSF land still remains in Itasca, Nerstrand Woods, Savanna Portage, and Hill Annex Mine state parks.

Sale of lakeshore lots that had previously been leased by individuals was authorized by the Legislature in each year 1988 through 1993. The sale authorization was provided as an option because those leasing the lots were objecting as lease rates were being increased over a number of years to be comparable with non-state leases. During this period, a total of 1,156 lakeshore lots were sold at public auction. Approximately 90 percent of the lots were on PSF land. A total of \$14.1 million in down payments and contracts for deed has been credited to the PSF for lakeshore land sold.

Legislation passed in 1998 required the DNR to exchange the remaining 582 lakeshore leases with land from the county in which the lease existed. The counties are then required to offer the lots for sale to the current lessees. The exchange process allows the lots to be offered to the lessees without going through a public auction. As of January 2001, Cook, Hubbard and Koochiching counties have completed the land exchanges. Five counties (Beltrami, Cass, Crow Wing, Lake and St. Louis) have had their land exchanges approved by the Land Exchange Board and are scheduled to be completed April 2001. Three counties (Aitkin, Itasca and Polk) are still in the early stages of exchange, estimated to be completed by June 2001. Approximately 97percent of the land received in exchange of the lakeshore leases are managed by the DNR Division of Forestry. <sup>9</sup>

Approximately 50 percent of the wild rice leases that the state administers are on PSF land. Discussions are ongoing about how to promote wild rice operations and also provide income to the PSF including the possibility of exchanging or condemning and selling the trust interest in the land.<sup>10</sup>

<sup>8</sup>February 1998, Legislative Audit Report on School Trust Land.

<sup>9</sup> Data updated from DNR presentation to the PSF Advisory Committee on September 21, 2000.

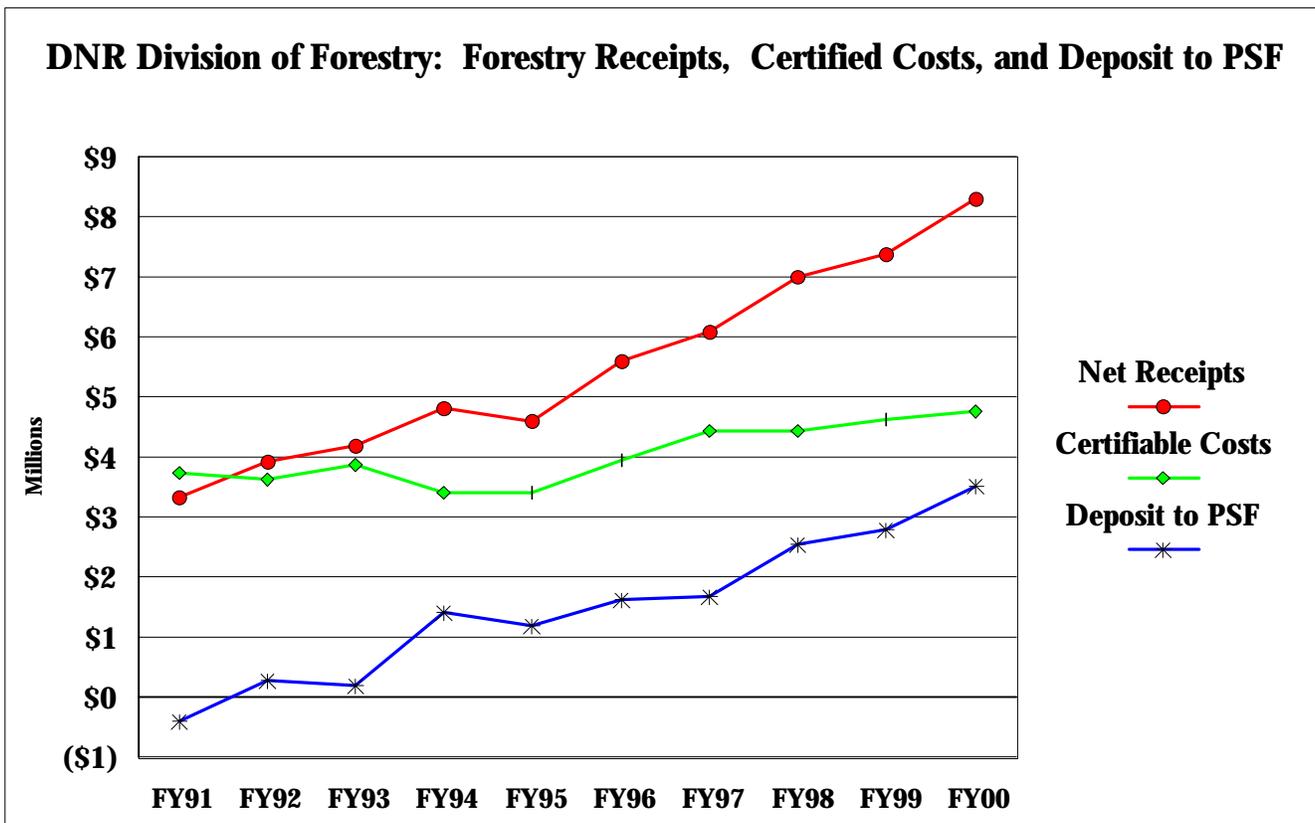
<sup>10</sup>Wild rice leases are authorized in M.S. 92.501.

Land is also leased for the removal of sand and gravel.<sup>11</sup> All these leases are administered by DNR.

DNR incurs considerable costs in the management, administration and protection of PSF land. State law allows the costs of protection, improvement, management and administration of state forest trust fund lands and construction and improvement of forest roads to be deducted from forestry proceeds earned by those lands.<sup>12</sup> Costs included are fire suppression protection, timber sale preparation, timber regeneration, law enforcement, insect and disease protection, soil survey and general office operations.

The amounts of forestry receipts on PSF lands and the amount deducted from those proceeds for DNR uses in recent years are shown in the chart below<sup>13</sup>.

Figure 2



The costs that DNR incurs for management, administration and protection of non-forest lands are covered by the state general fund appropriation for the operation of the agency.

<sup>11</sup>Leasing authorized in M.S. 92.50.

<sup>12</sup>M.S. 16A.125.

<sup>13</sup>Data from DNR certifications required under M.S. 16A.125.

## **The PSF Principal Must Remain Perpetual and Inviolable**

The principal of the PSF must remain perpetual and inviolable forever.<sup>14</sup> The market value of the principal of the PSF was \$579,000,000 as of June 30, 2000.<sup>15</sup> The principal is managed by the Department of Finance and invested by the SBI.

The Commissioner of the Department of Children, Families, and Learning is authorized to accept donations for deposit in the PSF.<sup>16</sup>

The principal in the fund has been generated from a variety of sources. The single largest source of revenue has been proceeds from mineral sales and mineral exploration. About three fourths of the PSF principal has been generated by rentals and royalties for leasing lands and removing minerals from PSF lands and from the iron ore occupation tax. About ten percent of the PSF principal has been generated by timber sales. The remaining PSF principal has come from the sale of PSF land, easements from lakeshore leases, wild rice leases, agricultural leases, utility licenses and other commercial leases. Although about two-thirds of the PSF land has been sold, the sale of land has contributed less than ten percent of the PSF principal.<sup>17</sup>

In 1991, \$5.25 million was added to the PSF principal from the sale of the Minnesota Educational Computing Corporation.<sup>18</sup>

The SBI invests the PSF principal to produce a high, consistent level of income for the fund within the existing legal and fiscal limits. Several legal restrictions limit the investment of the PSF principal. Any realized net capital losses must be offset against dividend income before that income can be distributed to school districts. Any net realized gain on the sale of investments must be added to the principal of the fund. Net interest and dividend earnings are distributed in the year in which they are earned.<sup>19</sup>

Prior to fiscal year 1998, the PSF principal had been invested entirely in fixed income securities. This asset allocation maximized current income from the PSF but limited the long term growth. During the 1997 legislative session, estimates of current income from the PSF were reduced to allow for the approximately 50 percent of PSF investments to be shifted to equities. At the end of FY 2000, the asset mix of the PSF was 52.1 percent in domestic stocks, 46.4 percent in domestic bonds and 1.5 percent in cash.<sup>20</sup>

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<sup>14</sup>Minnesota Constitution Article XI, Section 8.

<sup>15</sup>Data from the State Board of Investment.

<sup>16</sup>M.S. 127A.32.

<sup>17</sup>Figures are estimates based on the March 1983, Permanent School Fund Management Report.

<sup>18</sup> See 1989 Laws, Chapter 202, Section 3.

<sup>19</sup>M.S. 11A.16.

<sup>20</sup> Letter from Howard Bicker to the Permanent School Fund Advisory Committee dated September 21, 2000.

## Investment Earnings are Distributed to School Districts

The interest earned by the investment of the PSF principal is distributed each year to school districts. This distribution is made on a per pupil unit basis as part of the general education formula allowance as part of state aid payments in September and March.<sup>21</sup> Because these funds are part of the general education formula, they, in effect, reduce the amount of state general fund money needed to fund that formula. Amounts distributed in recent school years are shown below:<sup>22</sup>

**Table 4: Distributions to School Districts**

1988-89	\$30,916,000
1989-90	32,967,000
1990-91	31,179,000
1991-92	34,382,000
1992-93	31,918,000
1993-94	33,772,000
1994-95	35,730,000
1995-96	31,190,000
1996-97	30,603,000
1997-98	23,392,000
1998-99	19,513,000
1999-2000	20,860,000
2000-01	22,240,000

## A Process Exists for Ongoing Review of PSF Issues

The Legislative Audit Commission, in a report issued in 1981, pointed out a number of areas where management of the PSF could be improved. In response to this the 1982 K-12 Education Finance Bill established the Permanent School Fund Advisory Committee.<sup>23</sup> This committee, made up of the chairs of the House and Senate Education Committees, the chairs of the House Ways and Means and Senate Finance Committees, the Commissioner of Children, Families, and Learning and two school superintendents, has met periodically since the summer of 1982 to review DNR management policies for PSF land and SBI management of the PSF principal. The PSF Advisory Committee is also designated, by state law, as the temporary trustee for PSF land that is involved in a land exchange.<sup>24</sup>

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<sup>21</sup>M.S. 127A.33.

<sup>22</sup>Information from the Department of Children, Families, and Learning and consolidated fund statements issued by the Department of Finance. These numbers show the amounts paid in September and March of a particular school year (fiscal year). The payments are the investment earnings accrued at those times. The State Board of Investment would report a different number for the actual earnings in the July 1 - June 30 fiscal year.

<sup>23</sup>M.S. 127A.30.

<sup>24</sup>M.S. 94.342, subdivision 5.