
The State Needs to Pay More Attention to School Trust Obligations

SUMMARY

The Department of Natural Resources (DNR) has special obligations to generate income from the school trust land it manages. According to a report issued by the Legislative Auditor's Office, that obligation sometimes conflicts with DNR's general land management policies and practices.

When Minnesota became a state, the federal government granted the state land "for the benefit of schools." While most of the land was sold in the 1880s, DNR still manages about 2.5 million acres of school trust land. Net income produced from the land is invested by the State Board of Investment, and the proceeds are distributed to public schools annually (about \$30 million in 1997). The state holds both the land and the Permanent School Fund in trust for the benefit of public schools.

Net revenues from the land added about \$41 million to the trust fund between 1986 and 1997. The sale of assets including mining royalties and land sales accounted for 84 percent of these revenues, while timber sales and land leasing accounted for 16 percent. Mining, land sales, and timber sales each contributed about one-third of revenues added to the trust fund in 1997.

Using an estimated value of about \$300 million for commercial forest trust land, the report estimates that the net return on asset value from timber sales has been less than 1 percent in recent years. The

report concludes that methods used to allocate most of DNR's forestry management (timber sales and land leasing) costs to the trust are reasonable. However, DNR and the Legislature may want to re-examine how fire protection and recreation management costs are allocated. Minerals management costs are financed with general fund appropriations.

The report notes that about 150,000 acres of trust land are in uses (such as state parks, scientific and natural areas, and the Boundary Waters Canoe Area Wilderness) that cannot generate income for public schools. Although DNR recognizes the need to compensate the trust for lost revenue, the department has not given a high priority to this effort. While DNR has purchased or exchanged some land to compensate the trust, it has initiated few sales or exchanges of school trust land in recent years. At times, DNR has emphasized its natural

resource management responsibilities over its fiduciary responsibilities to trust beneficiaries. The report urges DNR to reconsider some of its

Program Evaluation Report School Trust Land

March 3, 1998

Key Findings:

- The Department of Natural Resources (DNR) manages some trust land to secure a maximum long-term economic return and other trust land for natural resource purposes that do not generate revenue for the trust.
- DNR has not given a high priority to removing trust land from non-revenue generating uses.
- Overall, DNR's methods of allocating most forestry management costs are reasonable.

Recommendations:

- DNR should continue to pursue compensation for trust land in the Boundary Waters Canoe Area Wilderness.
- The Legislature should improve oversight of school trust land management by adding the Commissioner of Finance to the Permanent School Fund Advisory Committee
- The Legislature should require DNR to report regularly on trust land management.
- The Legislature should consider constitutional and statutory changes to maximize the fund's future growth.

*The report is available at our web site:
<http://www.auditor.leg.state.mn.us/pe9805.htm>.
Copies of the full report or summary are also available by
calling 612/296-4708.*

internal management policies and to pursue compensation for trust land in the Boundary Waters.

The report also looks at 546 leased lakeshore lots on trust land, which receive a great deal of public scrutiny but account for a small proportion of all trust land and revenues to the trust fund. Recent reappraisal of these lots resulted in valuation increases of 7 percent annually over the past 13 years. Economic analysis of whether to sell or continue leasing these lakeshore lots does not yield a definitive conclusion.

The Permanent School Fund Advisory Committee, composed of legislators and educators, is supposed to oversee DNR's management of school trust land. The report concludes oversight needs improvement. The committee has met irregularly, usually at the call of DNR. No agency has produced comprehensive annual financial or management reports on school trust land. The report recommends that the Legislature should add the Commissioner of Finance to the Permanent School Fund Advisory Committee, have the Finance Department staff the advisory committee, and require DNR to report regularly on trust land management activities.

The report also examines the State Board of Investment's investment of the Permanent School Fund, which had a market value of over \$437 million in 1997. The past policy of investing the trust fund in fixed-income securities seriously limited the fund's principal growth over the past decade. Lower investment returns, small additions to principal, and a high distribution rate have resulted in the fund's value not keeping pace with inflation. The report supports SBI's current policy of investing more of the fund in stocks. The report recommends that the Legislature consider statutory and constitutional changes to the fund's distribution policy and treatment of capital gains to maximize the fund's future growth.

Finally, the report suggests that the visibility of the trust fund could be increased if the fund's income was dedicated to specific school needs.

Copies of the report, entitled *School Trust Land*, may be obtained from the Office of the Legislative Auditor at 612/296-4708 or at <http://www.auditor.leg.state.mn.us/pe9805.htm>. For further information, contact Susan Von Mosch or Roger Brooks at 296-4708.