



School Trust Land Management and Oversight

SPECIAL REVIEW
May 2020

OFFICE OF THE LEGISLATIVE AUDITOR
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May 2020

Members of the Legislative Audit Commission:

In 2018, several legislators asked the Office of the Legislative Auditor to review how effectively the state oversees the management of Minnesota's school trust lands, specifically in light of changes the Legislature made in 2012. In response, we agreed to conduct a "special review" when staff resources became available, and we recently completed our work.

We concluded that the 2012 Legislature's changes have had only limited impact so far. The new advisory agency established in the executive branch—the Office of School Trust Lands—did not get staffed immediately, and its relationship with the Minnesota Department of Natural Resources was initially difficult. The Legislature also revamped a legislative oversight agency—now called the Legislative Permanent School Fund Commission—and that commission has been hampered by its lack of staffing.

The Office of School Trust Lands and Department of Natural Resources have undertaken some important recent initiatives, but these agencies and the Legislature will have to make further efforts to ensure that Minnesota public schools benefit fully from the state's school trust lands.

We received full cooperation from the Office of School Trust Lands and Department of Natural Resources. Jo Vos of our office provided assistance in researching this report.

Sincerely,

A handwritten signature in black ink, appearing to read 'Jim Nobles'.

James Nobles
Legislative Auditor

A handwritten signature in black ink, appearing to read 'Joel Alter'.

Joel Alter
Director, Special Reviews



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School Trust Land Management and Oversight

Summary

The Minnesota Department of Natural Resources (DNR) manages 2.5 million acres of state-owned “school trust land,” and the state has retained the rights to minerals under the surface of another 1.0 million acres of land no longer owned by the state. Minnesota’s acreage of school trust lands far exceeds the school trust land acreage in surrounding states. These lands are to be managed for the economic benefit of Minnesota’s public schools. The Permanent School Fund, established by the Minnesota Constitution, holds revenues generated from school trust lands, and a total of about \$36 million was allocated to school districts and charter schools from that fund in Fiscal Year 2019.

Six state agencies play roles in managing school trust lands or the revenues they generate. The 2012 Legislature made changes in the management structure—revamping a legislative body (now called the Legislative Permanent School Fund Commission, or LPSFC) and creating a new executive branch agency (the Office of School Trust Lands, or OSTL). Both of these entities play largely advisory roles.

We found that the impact of the Legislature’s 2012 organizational changes has been limited by several factors. It took three years for Governor Dayton to appoint a director of OSTL; DNR and OSTL have experienced some rocky relationships; and DNR has not implemented a clear set of performance measures for school trust lands. On the other hand, DNR and OSTL have worked constructively on long-range plans for school trust funds, and have taken some actions to improve management of those lands.

Several important challenges remain, however. The Governor and Legislature have not fulfilled a statutory requirement to reimburse the Permanent School Fund for those trust lands that are subject to designations or policy provisions that prohibit them from producing long-term economic returns. There are some school trust-related activities for which the roles of DNR and OSTL are not adequately distinguished in law. With very limited staffing, the LPSFC has not fulfilled its promise; for example, it has not produced its required annual reports (with recommendations for legislative actions), nor has it conducted legal reviews of trust land exchanges required by state law. In addition, the Legislature required DNR to sell or exchange at least \$3 million in state-owned nontrust lands by June 30, 2017, so that the proceeds could be used for the benefit of public schools. However, DNR only partially complied with this requirement, and DNR has not yet used the sale proceeds for the intended purpose. This report offers a number of recommendations to the Legislature and executive branch agencies for changes.



Introduction

Legislation adopted by the U.S. Congress of the Confederation in 1785¹ established a framework under which states set aside lands to help pay for public schools.² When Minnesota adopted its constitution in 1857 and became a state a year later, it managed certain parcels of land in every township for the financial benefit of the state's schools. These lands became known as "school trust lands." The Minnesota Constitution created a "perpetual school fund" (now called the Permanent School Fund) to hold the revenue generated from the lands until funds could be distributed to schools.³

In 2012, the Legislature modified the state's administrative framework for overseeing school trust lands.⁴ It created the Legislative Permanent School Fund Commission (LPSFC) and the executive branch Office of School Trust Lands (OSTL), in part, to advise the Department of Natural Resources (DNR) on trust land management. During the 2018 legislative session, two bills were introduced requesting that the Office of the Legislative Auditor (OLA) evaluate the governance relationships that the 2012 legislation established and the management of Permanent School Fund assets.⁵ Given policy makers' interest, OLA initiated a special review of the state's oversight structure for school trust lands. We asked the following questions:

- 1. So far, how has the organizational framework for overseeing school trust lands—as revised by the Legislature in 2012—worked in practice?**
- 2. Do the state entities responsible for overseeing school trust lands and the funds they generate have clear and distinct roles?**
- 3. Have the state entities with oversight responsibilities for school trust lands complied with key statutory requirements?**

¹ General Land Ordinance of 1785. The Congress of the Confederation was the governing body of the states between March 1, 1781, and March 4, 1789. It was succeeded by the U.S. Congress upon the ratification of the U.S. Constitution.

² The federal government granted lands to every state except the original 13 colonies and those states that were later carved out of one of the colonies (for example, Kentucky and West Virginia were originally part of Virginia). In addition, Texas—which had been an independent republic—was not required to set aside land for schools. Nevertheless, by the time it entered the union, Texas had already set aside about 42 million acres for public schools. Similarly, states originally part of the 13 colonies had also set aside lands to be managed for the benefit of public schools.

³ *Minnesota Constitution*, art. XI, sec. 8.

⁴ *Laws of Minnesota 2012*, chapter 249.

⁵ S.F. 2845 and H.F. 3168, 2018 Leg., 90th Sess. (MN). Both bills specifically requested that OLA evaluate "the governance relationships between the Legislative Permanent School Fund Commission, the Department of Natural Resources, and the school trust lands director." The Senate bill also required that OLA evaluate the feasibility of a program to authorize school districts to borrow money for capital improvements from the Permanent School Fund; OLA did not examine that issue.

Our review did not focus on DNR's day-to-day management of school trust lands. In addition, we did not examine in detail DNR's expenses for managing trust lands; that was the subject of a state Department of Management and Budget study.⁶

We also did not look at how school districts spend allocations they receive from the Permanent School Fund. Neither the law nor state constitution requires districts to spend the money in certain ways or report how they spent it.

Background

Defining School Trust Lands

When Minnesota became a territory in 1849, the federal government set aside sections 16 and 36 of every township for the benefit of schools.⁷ In 1858—when Minnesota became a state—the federal government granted Minnesota 2.9 million acres in trust lands to support public schools. Over the next eight years, the federal government gave Minnesota another 5.2 million acres, which the state eventually classified as school trust lands.

By 1900, Minnesota had sold many of its best trust lands to support public schools, including most of the rich agricultural trust lands in southern Minnesota. The state retained the rights to any minerals that might be under the surface of the trust lands sold after 1900; these are known as “severed mineral rights.”⁸

Of the 8.1 million acres given to Minnesota in the mid- to late-1800s, 2.5 million acres of school trust lands remain today, with an additional 1.0 million acres in severed mineral rights. About 92 percent of school trust lands are in ten northern Minnesota counties. Three counties account for 70 percent of the state's school trust lands: Koochiching (37 percent), St. Louis (20 percent), and Itasca (13 percent).

Since 1861, several state entities have managed Minnesota's school trust lands, including the State Board of Commissioners of School Lands (1861), the State Land Office (1862-1931), and the Department of Conservation (1931-1969). In 1969, the Legislature reorganized the conservation department into the Department of Natural Resources, where management of school trust lands remains today.⁹

⁶ Department of Management and Budget, Management Analysis and Development, *Costs for School Trust Lands Management: Current Approaches, Issues, and Potential Alternatives* (October 30, 2018). In September 2018, that department also issued a report (*School Trust Lands Funds and Accounts*) that examined the structure of state accounts for tracking school trust land revenues, expenditures, and earnings.

⁷ The Organic Act of 1849, sec. 18, March 3, 1849. As states and territories were settled, they were divided into townships, with each township being 36 square miles. Each township was further divided into 36 sections, with each section being 1 square mile (640 acres). In 1857, Congress passed legislation that said that lands in every Minnesota township equivalent to sections 16 and 36 shall be granted to the state for the benefit of the schools if sections 16 and 36 had been sold or otherwise disposed of.

⁸ *Laws of Minnesota* 1901, chapter 104, codified as *Minnesota Statutes* 2019, 93.01.

⁹ *Laws of Minnesota* 1969, chapter 1129, art. 3; and *Laws of Minnesota* 2008, chapter 357, sec. 2, codified as *Minnesota Statutes* 2019, 84.027, subd. 18.

Trustee Responsibilities

Minnesota's first constitution directed the State of Minnesota to act as trustee for school trust lands. The "trust" status of the lands imposes special obligations on trustees that

Duties of a Trustee

- Administer the trust
- Manage trust assets with undivided loyalty
- Delegate trustee duties only when reasonable
- Keep and render accounts
- Furnish information to beneficiaries
- Exercise reasonable care and skill in managing the trust
- Take and keep control of trust property
- Preserve trust property
- Enforce claims held by the trust
- Defend actions that may result in loss to the trust
- Keep trust property separate from other property
- Use reasonable care regarding bank deposits
- Make the trust property productive
- Pay income to the beneficiaries
- Deal impartially with beneficiaries
- Use reasonable care to prevent breach of the trust by co-trustees
- Follow the direction of persons given control over the trustee

SOURCES: Office of the Legislative Auditor, Program Evaluation Division, *School Trust Land* (March 1998), 9; and Washington State Department of Natural Resources, *The Federally Granted Trusts: What Makes Them Unique* (Sacramento, CA: Western States Land Commissioners Association, January 5, 1999), 2-42.

would not apply if the state simply owned the land. State law requires that trustees manage the lands for the economic benefit of public schools, balancing the interests of current and future beneficiaries so that long-term benefits are not sacrificed to maximize short-term gains.¹⁰

Trustees must also manage the lands efficiently and with "undivided loyalty."¹¹ Undivided loyalty means that trustees cannot divert resources to benefit others without compensating the trust for lost revenue. All actions trustees take on school trust lands should consider, first and foremost, their economic effect on public schools. The box to the left identifies key duties of a trustee.

2012 Changes

During the 2012 legislative session, some state policy makers and interest groups raised concerns about DNR's management of school trust lands. Bills proposed to create a board and an office independent of the department to oversee trust lands, leaving the department responsible for managing the state's other public lands, such as state parks and forests.¹²

Proponents of a separate trust lands office said DNR could not act with undivided loyalty—suggesting, for example, that DNR's conservation responsibilities conflicted with its duty to maximize revenues from trust lands.

Legislation passed by the 2012 Legislature required changes to the state's framework for overseeing school trust lands and revenues, but it did not remove DNR's responsibility for managing school trust lands. The legislation created two advisory bodies: the Legislative Permanent School Fund Commission (LPSFC) and the executive branch Office of School Trust Lands (OSTL).¹³

The LPSFC is required to annually make recommendations to the Legislature, OSTL, and DNR regarding management of school trust lands.¹⁴ The LPSFC replaced the

¹⁰ *Minnesota Statutes* 2019, 84.027, subd. 18(a)(5).

¹¹ *Minnesota Statutes* 2019, 84.027, subd. 18(a)(1).

¹² H.F. 2244, 2012 Leg., 87th Sess. (MN). Similar legislation was introduced in 2018, but it did not receive a hearing. S.F. 2737, 2018 Leg., 90th Sess. (MN).

¹³ *Laws of Minnesota* 2012, chapter 249, secs. 7-11, codified as *Minnesota Statutes* 2019, 127A.30 and 127A.351-127A.353.

¹⁴ *Minnesota Statutes* 2019, 127A.30, subd. 2.

Permanent School Fund Advisory Committee, which had been created in 1982. Unlike its predecessor, the revamped commission consists solely of legislators—six from the House and six from the Senate.¹⁵

The OSTL director is appointed by the governor with the advice and consent of the Minnesota Senate.¹⁶ OSTL is required by law to advise the governor, constitutional officers, LPSFC, and DNR commissioner on the management of school trust lands.¹⁷ The law requires that DNR provide OSTL with human resources, payroll, accounting, procurement, and other similar administrative services.¹⁸ According to state law,

If the school trust lands director has an irreconcilable disagreement with the commissioner of natural resources pertaining to the fiduciary responsibilities consistent with the school trust lands, it is the duty of the director to report the subject of the disagreement to the Legislative Permanent School Fund Commission and the governor.¹⁹

Other States

According to a 2015 review, 23 of the lower 48 states (mostly those west of the Mississippi River) manage what is left of their school trust lands, which total about 46 million acres nationwide.²⁰ As noted earlier, Minnesota still has about 2.5 million acres of its school trust lands. Among neighboring states, Iowa has no school trust lands left to manage, Wisconsin has about 5,200 acres, North Dakota has about 632,000 acres, and South Dakota has about 609,000 acres.

Minnesota's framework for managing school trust lands and the revenue they generate differs from those of most states. As Exhibit 1 shows, many states place management responsibility for their school trust lands in an agency or board separate from their natural resources or parks department. In this way, trust land staff need not necessarily balance economic return responsibilities with environmental, conservation, or recreational responsibilities.

¹⁵ The Permanent School Fund Advisory Committee was made up of the chairs of several House and Senate education, finance, and natural resources committees, the education commissioner, two school superintendents, and experts in forestry, minerals and mining, real estate development, renewable energy, finance and land management, and natural resources conservation.

¹⁶ *Minnesota Statutes* 2019, 127A.353, subd. 1.

¹⁷ *Minnesota Statutes* 2019, 127A.352 and 127A.353. In addition, *Minnesota Statutes* 2019, 127A.353, subd. 4, establishes duties for OSTL that include: evaluating the school trust land asset position; determining the estimated current and potential market value of school trust lands; proposing legislative changes that will improve the asset allocation of the school trust lands; developing long-term plans for managing school trust lands; submitting an annual OSTL budget and management plan to the Legislative Permanent School Fund Commission; and submitting recommendations to the commission and DNR on strategies for school trust land leases, exchanges, or sales.

¹⁸ *Minnesota Statutes* 2019, 127A.353, subd. 1.

¹⁹ *Minnesota Statutes* 2019, 127A.352, subd. 3.

²⁰ Peter Culp, Andy Laurenzi, Cynthia Tuell, and Alison Berry, *State Trust Lands in the West* (Cambridge, MA: Lincoln Institute of Land Policy, 2015), 6.

Exhibit 1: School Trust Land Management in Select States

State	School Trust Land Surface Acreage	Organizational Placement of School Trust Land Management Functions
Arizona	8,100,000	Separate trust lands department. Its decisions may be appealed to a separate board. Governor appoints commissioner and board members.
Colorado	2,880,000	Separate trust land board within natural resources department. Board appointed by the governor, and the board appoints a director.
Idaho	2,100,000	Separate trust lands board and department; board manages trust lands; board of five statewide elected officials hires the lands director.
Minnesota	2,500,000	Trust lands and other public lands managed by natural resources department.
Montana	4,600,000	Separate trust lands division in natural resources department. A board of five state-elected officials provides direction and sets policy. Department director hires the division director.
Nebraska	1,300,000	Separate trust lands board. Members appointed by governor; board hires director.
Nevada	3,000	Separate lands office for a number of state agencies, including the natural resources department. The office manages school trust lands and other state lands.
New Mexico	6,800,000	Separate trust lands office in public lands department; commissioner is also office director and is an elected official.
North Dakota	632,000	Separate trust lands board composed of five statewide elected officials; board appoints a commissioner; board also invests proceeds from disposal of trust lands.
Oklahoma	743,000	Separate trust lands office, managed by top four state elected officials and one appointee; office also invests trust land revenues. Governor appoints head of the office.
Oregon	768,000	Separate trust lands department, which works at the direction of state lands board composed of three statewide elected officials. Board appoints director.
South Dakota	609,000	Separate trust lands department, headed by a commissioner who is a statewide elected official.
Texas	719,000	Separate trust lands department. An elected state land commissioner heads the department, and a three-person board provides oversight.
Utah	3,400,000	Separate trust lands department, overseen by a seven-member board appointed by the Governor; department director appointed by the board.
Washington	1,800,000	Natural resources department oversees management of state trust lands. The commissioner of public lands is a statewide elected position and also serves as the top DNR administrator.
Wisconsin	5,200	Separate trust lands board, consisting of three officials holding statewide posts. The board appoints the head of the administrative agency that manages trust fund assets and lands.
Wyoming	3,00,000	Separate trust lands office, which serves at direction of two boards of statewide elected officials. Office director appointed by governor.

NOTES: States shown are generally members of the Western States Land Commissioners Association that have retained at least some of their original school trust lands. In addition to the approximate acreage shown, states may still have mineral rights on trust lands that were granted to them.

SOURCE: Office of the Legislative Auditor.

It is difficult to compare how well states manage their school trust lands, for several reasons. First, states differ in terms of their trust land acreage. The original amount of land granted to states by the federal government varied, depending on when each state entered the union. Likewise, states differ in the amount of trust lands that remain today. After its initial grant of school trust land, Minnesota set aside additional federal land grants to be used for the benefit of public schools; the extent to which other states did this is unclear.

Second, trust lands differ in their capacity to generate revenue. Nationwide, states generate revenue through oil and gas leases, sales of forest products, mineral leases and sales, agriculture and grazing leases, commercial and residential leases, and surface leases and sales. Oil and gas royalties have accounted for the largest share of school trust fund revenue nationally, but individual states vary in their access to such resources.²¹ The way trust lands are geographically distributed in a state may also affect their ability to generate revenue.²²

Third, there are differences in the enabling legislation for each state's school trust lands. As more territories became states, and as more states sold off their trust lands, federal requirements related to school trust lands became less flexible. Individual states also added their own requirements. Consequently, states may differ in terms of the revenue-generating activities permissible on trust lands, and they may also differ in investment practices, revenue disbursement practices, and use (by schools) of the funds received.

Agency Roles

We examined provisions in Minnesota law related to (1) the management and oversight of school trust lands and (2) the revenues generated by those lands.

Six state entities have management or advisory roles in overseeing Minnesota's school trust lands or the revenue they generate.

- The **Department of Natural Resources** “has the authority and responsibility” to manage school trust lands.²³ The department also advises the Legislative Permanent School Fund Commission and governor on land management issues.²⁴

²¹ Center for the School of the Future, *A Magnificent Endowment: America's School Trust Lands, Your Guide to Making a Difference*, <https://www.idl.idaho.gov/land-board/lb/documents-long-term/class-trust-lands.pdf>, showed that oil and gas royalties accounted for \$1.4 billion in school trust fund revenues in Fiscal Year 2010, or more than 60 percent of the total trust fund revenues nationally (pp. 28-29). Minnesota has no significant fossil fuel resources.

²² For example, large trust land parcels near residential or business areas may be more attractive to developers than geographically isolated or scattered parcels.

²³ *Minnesota Statutes* 2019, 84.027, subd. 18. Of the nearly 5.6 million acres of lands managed by DNR, nearly half (45 percent) are school trust lands. Of the roughly 12 million acres of land where the department manages mineral interests, about 3.5 million acres are school trust lands.

²⁴ *Minnesota Statutes* 2019, 127A.352, subd. 2.

- The **Department of Management and Budget** has statutory responsibility for managing the Permanent School Fund.²⁵ The department deposits and transfers revenues to and from the fund.
- The **State Board of Investment** is responsible for investing the Permanent School Fund, according to the Minnesota Constitution and state law.²⁶ The outcome of these investments help determine how much revenue will be available for school districts and charter schools.
- The **Department of Education** determines which public school districts and charter schools are eligible to receive distributions from the Permanent School Fund, and it periodically apportions available funds to eligible entities.²⁷
- The **Legislative Permanent School Fund Commission** and the **Office of School Trust Lands** advise other entities, including DNR, the State Board of Investment, and each other.²⁸

In addition, the Governor or Legislature can play roles in the oversight process. The following sections briefly discuss management and advisory roles related to school trust lands.

Management Roles

Generating Revenue

One of DNR's roles with respect to school trust lands is to manage the lands to generate revenue for the Permanent School Fund.²⁹ The box to the right identifies goals which the Legislature has set for DNR.

Overall, the department must manage the lands to maximize long-term economic return to the Permanent School Fund, "while maintaining sound natural resource conservation and management principles."³⁰ When management

Department of Natural Resources Management Responsibilities for School Trust Lands

- Manage school trust lands efficiently and with undivided loyalty.
- Reduce management costs and maximize deposits to the Permanent School Fund.
- Require returns of at least fair market value when selling, exchanging, or leasing school trust lands.
- Maximize long-term economic return while maintaining sound natural resource conservation and management principles.
- Balance short-term and long-term benefits.
- Maintain the integrity of the trust and prevent misapplication of its lands and revenues.
- Give precedence to long-term economic return when there are irresolvable conflicts between competing goals.
- Compensate the Permanent School Fund before restricting the ability of school trust lands to generate revenue.

SOURCE: *Minnesota Statutes* 2019, 84.027, subd. 18.

²⁵ *Minnesota Statutes* 2019, 11A.16, subd. 3.

²⁶ *Minnesota Constitution*, art. XI, sec. 8; and *Minnesota Statutes* 2019, 11A.16, subd. 4.

²⁷ *Minnesota Statutes* 2019, 127A.32 and 127A.33.

²⁸ *Minnesota Statutes* 2019, 127A.352 and 127A.353.

²⁹ *Minnesota Constitution*, art. XI, sec. 8, defines the Permanent School Fund and places some restrictions on its management.

³⁰ *Minnesota Statutes* 2019, 84.027, subd. 18(a)(4).

goals conflict in a way that is “irresolvable,” however, DNR’s fiduciary responsibility to earn long-term revenue for the Permanent School Fund must take precedent, according to state law.³¹ If the lands’ ability to generate revenue for the fund is not negatively affected, the department can manage the lands to enhance other public benefits, such as providing public access or maintaining fish and wildlife habitats.

School trust lands in Minnesota earn revenue through three major types of activities, as shown in the box to the right: subsurface mineral leases and royalty payments,³² surface leases and sales of surface materials, and various real estate transactions.³³

The Department of Natural Resources’ management of school trust lands generated total income of \$27.0 million and \$35.7 million in fiscal years 2018 and 2019, respectively. As Exhibit 2 shows, minerals management revenues accounted for 46 percent of the total income in Fiscal Year 2018 and 60 percent in 2019.³⁴ Forest management revenues, such as revenues from timber sales, accounted for 52 percent and 39 percent of trust land total income in fiscal years 2018 and 2019, respectively. Real estate activities, such as land sales not counted in the “minerals management” and “forest management” categories, made up less than 2 percent of total income in each fiscal year.

Revenue-Generating Activities on School Trust Lands

- **Subsurface leases and royalty payments**
 - Iron ore and taconite
 - Industrial minerals, such as dimension stone, silica sand, and diamonds
 - Nonferrous metallic minerals, such as copper-nickel, gold, and platinum
 - Other minerals
- **Surface leases and sales**
 - Timber
 - Construction aggregates, such as sand and gravel
 - Land leases, such as trail, cabin, and agricultural leases
 - Peat
- **Real estate transactions and fees**
 - License fees for utilities, water crossings, and other items
 - Easements
 - Campground fees
 - Land sales

SOURCE: Office of the Legislative Auditor.

³¹ *Minnesota Statutes* 2019, 84.027, subd. 18(b).

³² Royalties are negotiated payments made to the mineral rights owner (DNR) by lessees (generally mining companies) for the minerals they remove from the land. DNR may also receive fees from mining companies during the period when the companies are exploring for minerals.

³³ State law builds in certain checks on DNR’s authority to manage school trust lands. For example, the state’s Executive Council, which is established in *Minnesota Statutes* 2019, 9.011, and consists of the state’s five constitutional officers, must approve all taconite leases, nonferrous metallic mineral leases, industrial mineral leases greater than 160 acres, and peat leases of at least 320 acres. In addition, the Land Exchange Board, which is established by *Minnesota Statutes* 2019, 94.341, and composed of the governor, state auditor, and attorney general, must approve exchanges involving school trust lands.

³⁴ Various factors affect the amount of revenue that school trust lands earn from year to year. According to DNR, the Fiscal Year 2017 drop in mineral revenues was due largely to increases in steel imports and reductions in iron ore pellet prices. To provide some economic relief to three of its major lease holders, the state Executive Council—on DNR’s recommendation—temporarily reduced royalty payments; this, in turn, reduced revenue for the Permanent School Fund.

Exhibit 2: Trust Land Revenue Generated and Deposits to the Permanent School Fund by Activity Type, Fiscal Years 2012-2019

	Fiscal Year (\$ in thousands)							
	2012	2013	2014	2015	2016	2017	2018	2019
Total Income Generated								
Minerals management	\$29,496	\$30,731	\$47,432	\$32,323	\$21,524	\$11,589	\$12,571	\$21,430
Forest management ^a	8,698	7,940	10,229	12,495	12,112	11,591	14,134	14,113
Real estate transactions	148	422	2,051	281	302	357	343	194
Total	\$38,343	\$39,093	\$59,712	\$45,099	\$33,938	\$23,537	\$27,049	\$35,736
Income Deposited to the Permanent School Fund								
Minerals management	\$29,496	\$30,731	\$47,432	\$32,323	\$21,524	\$11,589	\$12,571	\$21,430
Forest management ^a	2,293	835	83	2,204	4,131	3,187	1,383	3,770
Real estate transactions	148	422	2,051	281	302	357	343	194
Total	\$31,937	\$31,988	\$49,566	\$34,808	\$25,958	\$15,133	\$14,298	\$25,394

^a Data for minerals management show revenue generated in the same year in which it was deposited in the Permanent School Fund. Due to statutory requirements, data shown for forest management were actually earned the previous fiscal year, but deposited in the Permanent School Fund the following year. Revenue and deposits for certain types of real estate transactions may be reflected in the amounts shown for minerals management or forest management due to statutory requirements.

SOURCE: Minnesota Department of Natural Resources.

As the exhibit shows, not all of the income generated from school trust lands is deposited into the Permanent School Fund. The extent to which each type of activity contributes to the fund depends on many factors, including (1) allowable management costs for DNR and (2) legislative appropriations for trust-related activities.

Annual deposits to the Permanent School Fund have largely reflected revenues the state has received from minerals management on school trust lands.

Minerals management—such as subsurface mineral leases and royalty payments—has regularly accounted for the largest portion of school trust fund income deposited into the Permanent School Fund. In fiscal years 2018 and 2019, minerals revenue accounted for 88 percent and 84 percent of income deposited into the Permanent School Fund, respectively.

The extent to which DNR is reimbursed for its management costs depends on the type of revenue-generating activity. State law allows the department to be reimbursed for certain management costs related to trust land forests.³⁵ A 2018 study found that

³⁵ *Minnesota Statutes* 2019, 16A.125, subd. 5(c) and (d). Reimbursable expenses include improving, administering, and managing trust land forest lands, and constructing and improving forest roads to enhance the lands' value. The extent of DNR's management costs affects the amount of revenue deposited in the Permanent School Fund.

DNR's Forestry Division uses a "conservative approach when identifying school trust forest management costs and allocating them to school trust lands"; it said this keeps DNR's school trust land forestry costs relatively low and its "operating margins" higher for school trust lands than for other DNR-managed forest lands.³⁶ The department can also recover some of its management costs related to extraction of surface materials other than timber—such as gravel and sand—from school trust lands, and its costs for some, but not all, types of real estate transactions.³⁷

State law does not identify specific DNR costs that are reimbursable for *mining-related* activities on trust lands. Instead, the law credits 20 percent of the total income from royalty payments, lease payments, or other payments to the state generated from subsurface activities on both school trust and non-school trust lands to a "minerals management account"; DNR can use funds from this account "for the administration and management of state mineral resources."³⁸ The remaining 80 percent of the revenue generated from subsurface activities on school trust lands is assigned to various statutorily specified purposes, including the Permanent School Fund.³⁹

Because state law does not allow the department to be directly reimbursed for all of its real estate activities on trust lands, the Legislature has made special appropriations to DNR for some transactions, such as land exchanges and sales. For example, in 2013 and again in 2015, the Legislature appropriated \$200,000 from the revenue earned from surface-related activities on trust lands to DNR to (1) accelerate land exchanges, land sales, and commercial leasing of school trust lands; and (2) identify, evaluate, and lease construction aggregate on school trust lands.⁴⁰

Some non-DNR costs are, by law, also subtracted from the revenue generated from school trust lands. For example, annual appropriations for operating costs of the LPSFC and OSTL reduce the revenue that is available for deposit into the Permanent School

³⁶ Department of Management and Budget, Management Analysis and Development, *Costs for School Trust Lands Management: Current Approaches, Issues, and Potential Alternatives* (Office of School Trust Lands, September 2018), 26-27.

³⁷ For example, the department can recover some costs related to leasing cabins on school trust lands, but it cannot recover its costs for managing trust land campgrounds. Likewise, when DNR holds a public auction to sell school trust land parcels, DNR bears responsibility for the cost of parcels that do not sell.

³⁸ *Minnesota Statutes* 2019, 93.22, subd. 1(a) and (b); and 93.2236. *Minnesota Statutes* 2019, 93.2236(b), says that if the balance in the minerals management account exceeds \$3.0 million at the end of a given quarter of the year, the amount exceeding \$3.0 million must be distributed to the Permanent School Fund and other designees, as specified in the statute. DNR manages the mineral rights on roughly 12 million acres of state-administered land, including 3.5 million acres of school trust land.

³⁹ *Minnesota Statutes* 2019, 93.22(c)(1).

⁴⁰ *Laws of Minnesota* 2013, chapter 114, art. 3, sec. 4, subd. 2; and *Laws of Minnesota* 2015, First Special Session, chapter 4, art. 3, sec. 3, subds. 1-2. The appropriations came from revenue generated by trust lands, not the General Fund.

Fund. In addition, the Legislature sometimes appropriates funds for OSTL projects from trust land revenue before it is deposited into the Permanent School Fund.⁴¹

Managing and Investing the Permanent School Fund

State law gives the state Department of Management and Budget (often called MMB) overall management responsibilities for the Permanent School Fund.⁴² In addition, the law requires MMB to “certify” DNR’s management expenses related to forestry costs.⁴³ MMB also oversees the monthly transfer of interest generated by school trust lands into the Permanent School Fund, and it periodically transfers fund earnings to the Department of Education.

The Minnesota Constitution created the State Board of Investment (SBI) to administer and direct the investment of all state funds, including the Permanent School Fund.⁴⁴ The board is composed of the governor, state auditor, secretary of state, and attorney general. Within limitations prescribed by law, SBI must invest the money in the Permanent School Fund to provide for the maximum economic return possible, with its principal “perpetual and inviolate forever.”⁴⁵

At the close of Fiscal Year 2019, the fund’s market value was about \$1.5 billion.⁴⁶ Prior to 1998, SBI’s investment policy called for investing all of the Permanent School Fund in fixed-income bonds. Current board policy calls for investing 50 percent of the fund in stocks, 48 percent in fixed-income bonds, and 2 percent in cash.⁴⁷

Over the past ten years, the Permanent School Fund had an annualized return of 9.6 percent, and its performance has exceeded that of a comparable index.

According to SBI, “The State Board of Investment invests the Permanent School Fund to produce a growing level of spendable income for school districts within the constraints

⁴¹ For example, the 2015 Legislature appropriated \$600,000 to OSTL for the fiscal year 2016-2017 biennium “to accelerate land exchanges, land sales, and commercial leasing of school trust lands and to identify, evaluate, and lease construction aggregate located on school trust lands.” The appropriation came out of the Forest Suspense Account, which is the account DNR uses to deposit the revenue it earns from school trust land forests before allowable management expenses are subtracted. *Laws of Minnesota* 2015, First Special Session, chapter 4, art. 3, sec. 9. In 2017, the Legislature appropriated \$600,000 for the fiscal year 2018-2019 biennium to OSTL for “securing long-term economic return from the school trust lands consistent with fiduciary responsibilities and sound natural resources conservation and management principles.” It also appropriated \$500,000 to OSTL to initiate the private sale of school trust lands unable to generate revenue due to a policy or legislative designation. Both appropriations reduced revenue going into the Permanent School Fund. *Laws of Minnesota* 2017, chapter 93, art. 1, sec. 9.

⁴² *Minnesota Statutes* 2019, 11A.16, subd. 3.

⁴³ *Minnesota Statutes* 2019, 16A.125, subd. 5(c).

⁴⁴ *Minnesota Constitution*, art. XI, sec. 8.

⁴⁵ *Ibid.*

⁴⁶ State Board of Investment, *2019 Annual Report* (St. Paul, December 2019), 114.

⁴⁷ State Board of Investment, *Investment Policies and Management Practices* (St. Paul, May 2013), 16.

of maintaining adequate portfolio quality and liquidity.”⁴⁸ In the most recent year for which data are available (Fiscal Year 2019), the fund provided a return of 9.6 percent. The bond portion of the fund in that year outperformed its benchmark index (Bloomberg Barclays U.S. Aggregate), while the stock portion of the fund had returns equal to those of its benchmark index (S&P 500). Annualized rates of return over the last three, five, and ten years—ending in Fiscal Year 2019—show SBI’s investment of the Permanent School Fund did better than comparable benchmarks, as shown in the box below.⁴⁹ In Fiscal Year 2019, the fund generated “spendable income” of \$36 million.⁵⁰ Twice a year, in March and September, SBI reports to MMB on the amount of interest and dividends earned from the fund. MMB then transfers the fund’s earnings to the Minnesota Department of Education (MDE) for distribution.

The Permanent School Fund had Higher Annualized Returns than a Comparable Index in Recent Years.

	<u>Three-year</u>	<u>Five-Year</u>	<u>Ten-Year</u>
Permanent School Fund	8.7%	7.1%	9.6%
Composite Index	8.3%	6.9%	9.3%

Paying School Districts

MDE distributes the interest and dividends earned from investing the Permanent School Fund to schools in the manner prescribed in state law. School districts, including charter schools, that have been in session at least nine months receive revenue from the fund based on their average daily membership (ADM) the previous school year, regardless of whether their boundaries contain trust lands.⁵¹

School districts and charter schools received about \$33.0 million and \$36.0 million in funding from school trust lands in fiscal years 2018 and 2019, respectively. In Fiscal Year 2019, they received \$41.67 per ADM. Total revenue per operating school district or charter school averaged \$73,460 in Fiscal Year 2019, with a median amount of \$25,004. The district that received the largest amount of revenue in Fiscal Year 2019 was the Anoka-Hennepin School District, which received almost \$1.6 million.

Advisory Roles

Two state entities, both created in 2012, have primarily advisory roles: the Legislative Permanent School Fund Commission (LPSFC) and the Office of School Trust Lands (OSTL).

OSTL, which has three staff, is responsible for advising the Legislative Permanent School Fund Commission, DNR, governor, and state Executive Council on

⁴⁸ State Board of Investment, *2019 Annual Report* (St. Paul, December 2019), 114.

⁴⁹ “Annualized” returns are calculated as geometric averages to reflect what an investor would earn over a multiyear period if the annual returns were compounded.

⁵⁰ State Board of Investment, *2019 Annual Report* (St. Paul, December 2019), 115.

⁵¹ Average daily membership (ADM) is the sum for all pupils of the number of days in the district’s school year that each pupil is enrolled, divided by the number of days the schools are in session.

management of school trust lands.⁵² With input from DNR, the office is required by law to develop long-range strategic plans for managing trust lands.⁵³ In addition, the office has authority to “submit recommendations on strategies for school trust land leases, sales, or exchanges” to DNR and the Legislative Permanent School Fund Commission.⁵⁴ The office is also authorized by law to serve as temporary trustee of school trust lands subject to condemnation proceedings, and it is required by law to act as temporary trustee in land exchanges involving school trust lands.⁵⁵

The LPSFC is responsible for reviewing legislation, advising OSTL and DNR on the management of trust lands, and preparing an annual report for the Legislature.⁵⁶ In addition, LPSFC is required by law to provide independent legal counsel to review land exchanges involving school trust lands.⁵⁷ It may also make recommendations regarding the Permanent School Fund. Since its formation in 2013 through the end of 2019, the commission held 27 meetings, often during the legislative session. The commission’s sporadic meeting schedule has not allowed OSTL to comply with a statutory requirement for that office to report to the LPSFC at least once each quarter at a public meeting.⁵⁸

Impact of 2012 Legislative Changes

This section focuses on the management of school trust lands in the years subsequent to the Legislature’s 2012 structural changes. It is worth noting that DNR—also in 2012—issued an “operational order” to clarify its management objectives for school trust lands.⁵⁹ The order outlined a set of actions for the department to undertake. The order did not propose any measures for evaluating the department’s management of school trust lands, but it said that the department would regularly report performance information. For example, the order said DNR would present quarterly reports to the DNR commissioner and Permanent School Fund Advisory Committee (the LPSFC’s predecessor) on “actual and forecasted annual revenues generated from School Trust lands, actual and forecasted annual costs attributed to School Trust lands, market trends and performance metrics.”⁶⁰

⁵² The Executive Council consists of the state’s five constitutional officers: governor, lieutenant governor, secretary of state, state auditor, and attorney general.

⁵³ *Minnesota Statutes* 2019, 127A.353, subd. 4(a)(6).

⁵⁴ *Minnesota Statutes* 2019, 127A.353, subd. 4(b)(7).

⁵⁵ *Minnesota Statutes* 2019, 127A.353, subd. 4(b)(6); and 94.342, subd. 5. In addition, *Minnesota Statutes* 2019, 127A.353, subd. 4, establishes duties for OSTL that include: evaluating the school trust land asset position; determining the estimated current and potential market value of school trust lands; proposing legislative changes that will improve the asset allocation of the school trust lands; and submitting an annual OSTL budget and management plan to the Legislative Permanent School Fund Commission.

⁵⁶ *Minnesota Statutes* 2019, 127A.30.

⁵⁷ *Minnesota Statutes* 2019, 94.342, subd. 5.

⁵⁸ *Minnesota Statutes* 2019, 127A.353, subd. 4(a)(8).

⁵⁹ Department of Natural Resources, *Operational Order 121: Management of School Trust Lands*, February 23, 2012.

⁶⁰ *Ibid.*, 3. The order also called for annual reports to the Commissioner of Education and the LPSFC on trust land revenues, costs, and priorities.

It is challenging to assess the adequacy of school trust land management partly because DNR has not developed a clear set of performance measures.

In 2018, a study by the state Department of Management and Budget cited a need for DNR to improve its performance data related to school trust lands. The study noted that DNR had produced comparisons of the cost of school trust land forestry operations with forestry costs on other public and private lands. However, it said:

A focus instead on revenue generation and economic returns from school trust forest land would better align with the goals for the trust. No annual performance measures are produced for minerals management, which generates the bulk of net revenues to the school trust.⁶¹

DNR and OSTL are currently working on the development of an asset management plan, which will serve as a 25-year framework for management of school trust lands; the plan is scheduled for completion in early 2021. One of the intended outcomes of that plan is development of improved performance measures to assist in the assessment of school trust lands management. According to OSTL,

No universal financial performance indicator is available that can comprehensively evaluate the type of diverse portfolio represented by Minnesota's school trust lands. Instead, a variety of measures and targets may be considered to measure the performance of the entire asset portfolio as well as the individual asset classes that comprise the portfolio.⁶²

Up to now, DNR has not produced an array of performance measures of the sort it proposed in 2012 for periodically reporting on school trust fund management outcomes. Without such measures, however, it may be difficult for legislators, agency leaders, and the public to assess the effectiveness and efficiency of school trust lands management. We urge the department to develop and begin tracking an array of measures as a part of its current long-range planning activities for school trust lands.

RECOMMENDATION

The Department of Natural Resources—with input from the Office of School Trust Lands—should develop a comprehensive set of measures to help assess the management of school trust lands and the revenue they generate.

⁶¹ Department of Management and Budget, Management Analysis and Development, *Costs for School Trust Lands Management: Current Approaches, Issues, and Potential Alternatives* (St. Paul, September 2018), 21. DNR told us that it agrees with the need for measures of school trust land management, but it said that measures of mineral-related performance will be largely out of DNR's control—for example, reflecting conditions in the steel market and the investment market for nonferrous exploration.

⁶² Office of School Trust Lands and Department of Natural Resources, *Developing an Asset Management Plan for School Trust Lands*, https://mn.gov/school-trust-lands/assets/STL%20Asset%20Management%20Plan%20White%20Paper_tcm1107-408153.pdf, accessed February 4, 2020.

In the rest of this section, we review factors that have affected the impact of the 2012 legislative changes: (1) the extended time it took for the changes to be implemented and (2) inaction by the Governor and Legislature in compensating the Permanent School Fund. In addition, we discuss actions by DNR and OSTL that indicate progress but have not yet yielded significant impacts on the Permanent School Fund.

Slow Start

It has been eight years since Governor Dayton signed legislation that modified the state's structure for managing and overseeing school trust lands. The 2012 legislation took effect July 1, 2013.

The impact of the Legislature's organizational changes was delayed by the time it took to start up the Office of School Trust Lands and by early difficulties in interagency relationships.

In practice, it took several years to implement the restructuring the Legislature initiated in 2012. For example, Governor Dayton did not appoint a director of the Office of School Trust Lands until September 2015. In addition, DNR and the new Office of School Trust Lands have had to develop policies and procedures that did not exist previously.

The relationship between DNR and the newly staffed OSTL was strained from the beginning—despite the fact that Governor Dayton selected DNR's school trust lands administrator to be the first director of OSTL.⁶³ According to OSTL, DNR did not always notify OSTL about information that OSTL considered necessary to do its work. In turn, DNR said OSTL sometimes overstepped its authority and that DNR lacked complete understanding of what it needed to provide to OSTL.

In July 2017, Governor Dayton's office asked the Bureau of Mediation Services to help DNR and OSTL resolve their differences.⁶⁴ In April 2018, DNR, Governor Dayton's office, and OSTL entered into a formal agreement detailing: (1) each entity's statutory responsibilities and their duties to one another, (2) processes and timelines for exchanging information and keeping each other informed of their respective activities, and (3) internal processes to reconcile their differences.⁶⁵ Furthermore, DNR and OSTL agreed to develop and support an approach by which the Legislature could compensate the Permanent School Fund for all lands prevented by designation or policy provision from generating long-term economic return.⁶⁶

⁶³ DNR first appointed a school trust land administrator in 2012 to oversee its management of school trust lands.

⁶⁴ A legislator told us that the Governor's Office intervened partly at the urging of legislators.

⁶⁵ Office of School Trust Lands, Office of the Governor, and Department of Natural Resources, *Operating Agreement* (St. Paul, April 24, 2018).

⁶⁶ Bureau of Mediation Services, *Office of School Trust Lands/DNR Collaborative Problem Solving Process Summary* (St. Paul, undated), 3.

Some parts of the DNR-OSTL relationship improved after the agencies signed their agreement in April 2018.⁶⁷ For example, OSTL had more than 20 “informal” meetings with staff from the DNR commissioner’s office and DNR divisions between April and September 2018. In addition, OSTL and key DNR representatives have met on a monthly and quarterly basis, as specified in the 2018 agreement between the agencies and a 2020 update to the agreement.⁶⁸ OSTL, in conjunction with DNR, issued a ten-year strategic plan in 2018 for managing school trust lands.⁶⁹ As noted previously, both agencies are now working together on a 25-year framework for school trust lands management, mandated by state law.⁷⁰

Still, the DNR-OSTL relationship is a work in progress. A DNR official told us that disagreements between the two agencies regarding the school trust land condemnation process have contributed to “a really tense work environment.” The OSTL director told us that the DNR-OSTL relationship is “considerably better” than it was previously, but OSTL still has some difficulty getting information from DNR in a timely manner.

Inaction by the Governor and Legislature

Although state law designates DNR as the manager of state trust lands, DNR does not bear sole responsibility for the success or failure of school trust lands’ ability to generate revenues for the Permanent School Fund. Decisions made by the Governor and Legislature can also affect the amount of trust land revenue school districts receive.

The Governor and Legislature have not fulfilled a statutory requirement to fully reimburse the Permanent School Fund for school trust lands prohibited from generating revenue.

Legislation adopted in 2012 required that, by July 1, 2018, the Permanent School Fund be compensated for all school trust lands with a designation or policy provision that prohibits long-term economic return.⁷¹ DNR estimated that \$50 to \$100 million would

⁶⁷ Staff said that many informal meetings also occurred between OSTL and various DNR divisions and offices prior to signing the April 2018 agreement.

⁶⁸ The initial operating agreement called for monthly “informal check-in meetings” between OSTL and each of four DNR divisions and offices; quarterly meetings between OSTL and the Governor’s Office; quarterly meetings between OSTL and each of two DNR divisions; one “leadership” meeting between OSTL and DNR leaders each October; and one strategic objectives meeting each April. Office of School Trust Lands, Office of the Governor, and Department of Natural Resources, *Operating Agreement* (St. Paul, April 24, 2018).

⁶⁹ Office of School Trust Lands, *The 2018-2028 Strategic Plan* (St. Paul, 2018). The plan was required by *Minnesota Statutes* 2019, 127A.353, subd. 4(a)(6).

⁷⁰ *Minnesota Statutes* 2019, 127A.353, subd. 4(a)(6).

⁷¹ *Laws of Minnesota* 2012, chapter 249, sec. 4, codified as *Minnesota Statutes* 2019, 84.027, subd. 18(b).

be needed to compensate the fund for lost revenue.⁷² To date, however, the Legislature has appropriated little or none of this amount.⁷³

Since 2012, DNR's efforts to get compensation for school trust lands have focused largely on requests for capital bonding or other funding that would require approval from the Governor and Legislature. These efforts have produced no noteworthy results. For example, in 2012, Governor Dayton did not recommend funding DNR's capital budget request for \$5 million to begin to compensate the school fund for lost revenue.⁷⁴ Likewise, in 2014 and 2016, Governor Dayton did not approve DNR's capital budget requests for \$20 million to begin to pay the school fund for trust lands prohibited from generating revenue.⁷⁵ And, in 2018, Governor Dayton did not approve DNR's request for \$80 million to acquire and improve school trust lands for the purpose of compensating the Permanent School Fund.⁷⁶ Several times in recent years, DNR also tried to obtain funding from the Legislative-Citizen Commission on Minnesota Resources to acquire unproductive school trust lands, but these efforts were not successful.⁷⁷

State law currently requires that the Department of Management and Budget fund certain obligations whenever it determines that there will be an unrestricted balance in the General Fund based on forecasted revenues and expenditures at the close of the biennium.⁷⁸ During the 2017 and 2019 legislative sessions, some legislators introduced bills that would have directed the Department of Management and Budget to allocate a portion of the state's unrestricted General Fund positive balance (if any) at the close of the biennium to compensate the Permanent School Fund for economic losses due to restrictions on school trust lands.⁷⁹ The bills did not pass.

⁷² Department of Natural Resources, *Minnesota's School Trust Lands, Biennial Report, Fiscal Years 2012-2013* (St. Paul, December 2013), 6; and Department of Natural Resources, *Minnesota's School Trust Lands Valuation Report: Progress as of December 31, 2016* (St. Paul), 2.

⁷³ In 2017, the Legislature appropriated \$500,000 to OSTL to initiate the sale of school trust lands in the Boundary Waters Canoe Area Wilderness. (*Laws of Minnesota 2017*, chapter 93, art. 1, sec. 9.) However, OSTL told us that this appropriation covered the cost of "transactional work" and did not compensate the Permanent School Fund.

⁷⁴ Department of Management and Budget, *State of Minnesota 2012 Capital Budget Requests: Department of Natural Resources* (St. Paul, January 2012), 54-56.

⁷⁵ Department of Management and Budget, *State of Minnesota 2014 Capital Budget Requests: Department of Natural Resources* (St. Paul, January 2014), 31-33; and *State of Minnesota [2016] Capital Budget Requests: Department of Natural Resources* (St. Paul, January 2016), 97-100.

⁷⁶ Department of Management and Budget, *State of Minnesota Final [2018] Capital Budget Requests: Department of Natural Resources* (St. Paul, January 2018), 16-17.

⁷⁷ In addition to DNR's efforts to obtain legislative funding, there have also been state efforts to exchange or sell the 83,000 acres of school trust lands in the Boundary Waters Canoe Area Wilderness, which are subject to wilderness restrictions. DNR and OSTL have been working with the federal government and other interested parties on this project, which is intended to help the Permanent School Fund generate additional revenue.

⁷⁸ *Minnesota Statutes 2019*, 16A.152, subds. 1-2.

⁷⁹ H.F. 2499, 2017 Leg., 90th Sess. (MN) and S.F. 2258, 2017 Leg., 90th Sess. (MN); and H.F. 152, 2019 Leg., 91st Sess. (MN) and S.F. 617, 2019 Leg., 91st Sess.

RECOMMENDATION

Consistent with state law, the Legislature should compensate the Permanent School Fund for instances in which state policies or legislative actions have prohibited school trust lands from generating revenue.

This recommendation reflects a statutory deadline that—despite having been missed—remains in law. The language is mandatory, not permissive. It says: “By July 1, 2018, the permanent school fund must be compensated for all school trust lands included under a designation or policy provision that prohibits long-term economic return.”⁸⁰ However, in the six years leading up to that statutory deadline, Governor Dayton did not recommend any such funding, and the Legislature did not appropriate it. In our view, the Legislature has a legal and fiduciary obligation to compensate the Permanent School Fund for school trust lands that cannot produce revenues.

Following passage of the statutory requirement in 2012, the Governor and Legislature missed opportunities to comply during years when the state’s economy and state revenues were relatively strong. The 2020 economic downturn in the wake of the coronavirus pandemic may make it more difficult in at least the short-term for the Legislature to find revenues with which to fund this obligation. But, when circumstances allow, the Governor and Legislature should comply with this requirement.

DNR and OSTL Initiatives

Over the past decade, DNR initiated changes in how it manages school trust lands. Some of these changes predated the adoption of the 2012 school trust land governance legislation or the appointment of an OSTL director in 2015. In other cases, DNR has obtained OSTL’s input to initiate changes in school trust land management. Some of the important initiatives by DNR and OSTL have included the following:

- Starting in 2012, DNR assigned a staff person to work exclusively on school trust land administration.⁸¹
- DNR has started to develop guidance for its staff regarding how to manage school trust lands across the agency’s disciplines. In July 2018, DNR issued interim guidelines to help its staff integrate management objectives for trust land forests with the management of other DNR-administered forests.⁸² In 2020, these guidelines became permanent.⁸³ OLA recommended such

⁸⁰ *Minnesota Statutes* 2019, 84.027, subd. 18(b).

⁸¹ DNR made the school trust lands administrator position part time in 2016. In 2018, DNR increased staffing by adding a part-time school trust lands planner.

⁸² Department of Natural Resources, *Interim DNR Policy: Forest Management Guidelines for School Trust Lands* (June 28, 2018).

⁸³ Department of Natural Resources, *Best Management Practices for Forest Management on School Trust Lands* (March 2, 2020).

guidelines to DNR in a 2014 report.⁸⁴ DNR expects to issue detailed guidelines on four forest management-related subtopics during 2020, and DNR told us that OSTL has indicated its support for approval of these guidelines. DNR also plans to issue separate guidelines for managing mineral resources on school trust lands and trust land real estate and surface use transactions, but it has not done so yet.

- DNR had issued an internal policy (called Operational Order 121) for managing school trust lands in 2012, and it updated that policy in 2019. The updated policy clarified school trust land management practices, as well as dispute resolution and compensation procedures.⁸⁵ The policy also defined “sound natural resource conservation and management principles,” a term used in state law but which DNR said has been historically undefined.⁸⁶
- In 2013, DNR developed an inventory of all school trust lands prohibited from maximizing long-term revenue by their statutory designations or state policy.⁸⁷ Further, DNR proposed ways to compensate the Permanent School Fund—by purchasing or exchanging lands, or by changing the way school trust lands are managed—to maximize revenue potential for the fund.
- In 2013, as part of its efforts to develop a business plan for managing school trust lands, DNR identified the cost of management activities for school trust lands, including nonreimbursable expenses incurred by the state. At the time, DNR estimated that the school trust received a total annual subsidy of about \$7 million from various funding sources. DNR estimated that its own unreimbursed costs of managing school trust lands for the purpose of generating economic returns totaled \$3.2 million per year.⁸⁸
- OSTL, in conjunction with DNR, completed a ten-year strategic plan for school trust lands in 2018.⁸⁹ The two agencies are now working on a 25-year asset management plan for school trust lands. OSTL officials expressed confidence that the 25-year plan will yield strategies that will grow the size of the trust.

⁸⁴ Office of the Legislative Auditor, Program Evaluation Division, *DNR Forest Management* (St. Paul, 2014), 59.

⁸⁵ Department of Natural Resources, *Operational Order 121: Management of School Trust Lands* (April 19, 2019).

⁸⁶ This term is used in *Minnesota Statutes* 2019, 127A.31, which defines the goal of the Permanent School Fund.

⁸⁷ Legislation required that DNR develop such an inventory by December 31, 2013 (*Laws of Minnesota* 2012, chapter 249, sec. 4, codified as *Minnesota Statutes* 2019, 84.027, subd. 18(c)). The inventory was presented in the biennial school trust lands report DNR issued in December 2013. The legislation further required that the 2013 report, as well as future biannual reports, include “a plan to compensate the permanent school fund through the purchase or exchange of the lands or a plan to manage the school trust land to generate long-term economic return to the permanent school fund.” Subsequent biennial reports must report on progress in maximizing long-term economic returns on school trust lands.

⁸⁸ Department of Natural Resources, *Minnesota’s School Trust Lands, Biennial Report, Fiscal Years 2012-2013* (St. Paul, 2013), 26-27.

⁸⁹ Office of School Trust Lands, *The 2018-2028 Strategic Plan* (St. Paul, 2018).

- OSTL and DNR have been working together with the federal government and other entities to lay the groundwork for land exchanges or sales involving the school trust lands in the Boundary Waters Canoe Area Wilderness. There are about 83,000 acres of school trust land in this area that—because of the wilderness designation—do not have the potential to generate revenue for the trust. Land appraisals began in late 2019, and DNR told us that it estimates that a proposed exchange of land will be submitted to the state’s Land Exchange Board for approval in March 2021.

OSTL also obtained the services of the Department of Management and Budget’s Management Analysis and Development unit, which issued two reports in 2018 related to the management of school trust lands.⁹⁰ Those reports made findings and recommendations to state agencies and the Legislature that may still be pertinent. For example, one of the reports said, “Most experts agreed that sealed timber bids generate greater revenue than oral bids and recommended that DNR use sealed bids rather than oral bids for sales of [school trust land] timber.”⁹¹ However, OSTL told us that DNR still largely relies on oral bids when selling timber from state lands.

Areas of Potential Role Conflict

Actions by the 2012 Legislature—particularly the creation of an entirely new advisory agency (OSTL)—affected agency responsibilities in school trust land oversight and management. In the instances we discuss below, we think there is potential for agencies to have conflicting roles.

Land Condemnation and Appraisal Process

State law allows DNR to “extinguish the school trust interest” in school trust lands that are prohibited by policy or law from generating revenue for the benefit of Minnesota schools.⁹² In such cases, DNR can acquire the land through a condemnation process. The Minnesota Constitution limits the sale of school trust lands to public sales, and state law says that the condemnation process outlined in statute is intended to satisfy the constitutional requirements.⁹³ In such cases, the Permanent School Fund must receive payment for the value of the land.⁹⁴

⁹⁰ Department of Management and Budget, Management Analysis and Development, *Costs for School Trust Lands Management: Current Approaches, Issues, and Potential Alternatives* (October 30, 2018); and *School Trust Lands Funds and Accounts* (September 2018).

⁹¹ Department of Management and Budget, *Costs for School Trust Lands Management: Current Approaches, Issues, and Potential Alternatives*, 8.

⁹² *Minnesota Statutes* 2019, 92.83, subd. 1.

⁹³ *Ibid.*

⁹⁴ According to *Minnesota Statutes* 2019, 92.83, subd. 3, “The portion of the payment of the award and judgment that is for the value of the land shall be deposited into the permanent school fund. The remainder of the award and judgment payment shall first be remitted for reimbursement to the accounts from which expenses were paid, with any remainder deposited into the permanent school fund.”

State law's provisions regarding the school trust land condemnation and appraisal process have not been sufficiently clear to prevent disagreements between DNR and OSTL.

First, the law authorizes OSTL to be a temporary trustee of school trust lands in condemnation proceedings, but it does not require this. Specifically, the law says that the director of the Office of School Trust Lands “shall have the authority to” be temporary trustee for school trust lands in condemnation proceedings.⁹⁵ Because of the ambiguity in this language, some at DNR have questioned whether OSTL could—if it wishes—choose not to act as temporary trustee in these situations.⁹⁶ OSTL told us that it has acted as temporary trustee in each condemnation case that has arisen, but there could be scenarios—such as a condemnation of school trust land needed for a state road—in which it might not choose to act as the trustee.

Second, there are unresolved questions about how school trust lands should be valued in condemnation proceedings. DNR told us that OSTL has insisted on independent appraisals in all school trust land condemnation proceedings. We are unaware of a written OSTL policy on independent appraisals, and OSTL told us it does not have statutory authority to require such appraisals. However, OSTL acknowledged to us that it has recommended that DNR get appraisals done by outside experts, not by DNR staff. This would prevent the appearance of a conflict of interest, OSTL told us. In addition, OSTL said, independent appraisals may provide greater transparency and assurance of fairness to courts that review condemnation proceedings.

DNR is authorized in law to use a “minimal valuation” procedure when the commissioner determines that the value of land subject to acquisition is less than \$100,000.⁹⁷ DNR believes that such valuations—whether by its own appraisal staff or others—should be an acceptable basis for determining the fair value of school trust lands if, in the professional judgment of DNR’s appraisal staff, use of the minimal valuation procedure is appropriate in a given circumstance.⁹⁸ DNR contends that there is no conflict of interest when DNR staff perform appraisals or minimal valuations of school trust land because all DNR staff have a fiduciary responsibility to act as trustees of these lands. DNR staff believe that OSTL’s insistence on outside appraisals (rather

⁹⁵ *Minnesota Statutes* 2019, 127A.353, subd. 4(b).

⁹⁶ This language regarding land condemnation differs from more prescriptive language in statute regarding land exchanges. *Minnesota Statutes* 2019, 94.342, subd. 5, says, “School trust land may be exchanged with other class A land only if the school trust lands director is appointed as temporary trustee of the school trust land for purposes of the exchange.”

⁹⁷ *Minnesota Statutes* 2019, 84.0272, subd. 3.

⁹⁸ For example, *Minnesota Statutes* 2019, 94.343, subd. 2a, directs the DNR commissioner to ensure that exchanges involving state-administered lands have valuations of the lands based on procedures in *Minnesota Statutes* 2019, 84.0272. The latter statute says the commissioner “shall cause the lands to be appraised” by a person who has taken an oath to be an impartial appraiser (subd. 1). If the DNR commissioner determines that the value of the land is less than \$100,000, DNR may acquire the land for the DNR-determined value without an appraisal (subd. 3). *Minnesota Statutes* 2019, 92.115, subd. 1, requires the DNR commissioner to have state land appraised before sale “if the estimated market value is in excess of \$100,000.”

than DNR's minimal valuations) in condemnation proceedings involving land with relatively low values results in unnecessary state expenses.⁹⁹

Third, the law does not specify how to resolve disputes between OSTL and DNR in condemnation cases. DNR told us that it has always pursued “friendly condemnation”—that is, reaching a settlement through stipulation agreements—rather than by condemning land in a contested process. In school trust land condemnation agreements pursued previously, the seller of the land (OSTL, serving as temporary trustee) and the buyer (DNR) have stipulated that the terms of the condemnation are fair and appropriate. But if the two agencies disagree—for example, on the appraised value of the land—this can slow the process or stop it entirely. Exhibit 3 discusses a case in which DNR contended that OSTL blocked DNR's ability to manage school trust lands. As of May 2020, discussions were continuing between DNR and OSTL on how to proceed with appraisals in this project—more than 30 months after the two agencies started working together on the project.

There is a provision in law that requires the OSTL director to report to the Legislative Permanent School Fund Commission and governor about any “irreconcilable disagreement [OSTL has] with the commissioner of natural resources pertaining to the fiduciary responsibilities consistent with the school trust lands.”¹⁰⁰ OSTL told us that it has not encountered any irreconcilable differences—“not even close,” according to the OSTL director. In contrast, as noted in the example above, DNR thinks its ability to manage the trust lands has sometimes been hindered by OSTL's differing perspectives. While the law requires notification of the LPSFC and governor regarding irreconcilable disagreements, the law does not specify exactly how such disagreements should be resolved. An operating agreement entered into by DNR, OSTL, and the Governor's Office establishes a process for “reconciliation of differences” prior to OSTL notifying the LPSFC and Governor's Office of irreconcilable disagreements. This provision of the agreement is useful, but—as indicated above—some differences of opinion have continued for extended periods.

⁹⁹ DNR cited an example involving condemnation of a small parcel of school trust land on Watrous Island in northern Minnesota. DNR staff initially conducted a minimal valuation of the property and determined that its value was \$9,000. DNR estimated that its cost for conducting this valuation was less than \$600. DNR said that OSTL would not agree to proceed with the condemnation unless DNR had the land independently appraised. DNR did so—at a cost of \$7,500—and the appraiser determined a land value \$500 more than what DNR had determined.

¹⁰⁰ *Minnesota Statutes* 2019, 127A.352, subd. 3.

Exhibit 3: Example of a Project Involving Disputes about School Trust Land Condemnation and Appraisal

Project Overview: Minnesota Power is building a transmission line corridor through several northern Minnesota counties. The corridor includes a mix of state, county, and private lands. Portions of the project involve conversion of forest wetlands to grass wetlands, and the U.S. Army Corps of Engineers requires mitigation for such conversions. Under the agreed-upon mitigation, Minnesota Power will preserve stands of northern white cedar stands on school trust lands where deer spend the winter. Using funds from Minnesota Power, DNR plans to condemn the school trust interest on more than 1,400 acres in five separate locations in three counties (Cass, Itasca, and Koochiching). The Permanent School Fund will receive compensation for the value of these lands, and earnings on this deposit will benefit the fund in perpetuity. This project is known as the Cedar Deer Yards Project.

Land Appraisals: DNR hired an appraiser to determine the value of school trust lands in these five locations. DNR and OSTL agreed to have the appraiser determine the values under two scenarios: (1) public access to the lands remains as is and (2) enhanced public access to the lands will be provided across nontrust DNR-administered lands if the school trust lands do not currently have access. The appraiser valued the lands at \$756,600 and \$1,102,200, respectively, under the two scenarios.

Disagreements between DNR and OSTL: The two agencies began working on the condemnation process for these lands in September 2017, but they disagreed on which appraisal scenario was appropriate. DNR declined to sign “resumes of certified appraisal” for the second scenario above because it did not believe that this scenario complied with appraisal standards for determining fair market value. DNR said it would be inappropriate to appraise school trust lands to the potential detriment of other DNR-administered lands—by requiring that access easements be granted across the nontrust lands. DNR said that government appraisal standards require that if school trust land is assumed, for appraisal purposes, to have enhanced access, then DNR must, in fact, improve access to the lands. DNR contended that it cannot grant an access easement to itself over land that it holds in fee title. DNR said that OSTL’s reluctance to enter into stipulation agreements, in effect, blocked DNR’s ability to manage the school trust lands and move this project forward.

In contrast, OSTL said that DNR was treating the school trust lands as “privately owned inholdings” that do not have legal access. OSTL contended there is already legal access to most of the school trust parcels in question. OSTL said that DNR was not acting with undivided loyalty to the school trust, which violated its fiduciary duties. OSTL contended that DNR did not arrange for an external technical review of the appraisals, which would have revealed flaws in the appraisal approach. OSTL said that the proposed condemnation actions on the specified lands would reduce property values on other school trust lands—and if DNR were to do this, it would need to compensate the school trust for these actions.

DNR and OSTL resumed discussion about these disagreements in April 2020. DNR told us that, as of May 2020, discussions are ongoing about whether DNR should, in this instance, provide access to school trust land through adjacent DNR-administered nontrust land if the nontrust land has access and the school trust land does not. DNR said that after this issue is resolved, it will request new appraisals because the previous appraisals relied on erroneous land classification information. OSTL said the two agencies’ efforts to resolve disputes in this case will ultimately lead to a better result for school trust beneficiaries.

SOURCE: Office of the Legislative Auditor, based on documents, interviews, and correspondence with the Department of Natural Resources and Office of School Trust Lands.

RECOMMENDATION

The Legislature should consider clarifying in law:

- **Whether OSTL’s authority to act as a temporary trustee of school trust lands is mandatory in cases involving school trust land condemnations.**
 - **Procedures by which land valuations or appraisals for school trust land condemnation must be obtained, and whether those appraisals or valuations must be by parties other than DNR.**
 - **How disagreements between OSTL and DNR in the school trust land condemnation process should be resolved.**
-

State law authorizes DNR to manage school trust lands, while OSTL’s role in law is largely advisory. However, in cases in which OSTL (acting as temporary trustee of the land) disagrees with DNR—for example, regarding the proper value of land proposed for condemnation—OSTL may have an ability to block such transactions from moving forward. Current law does not adequately specify what processes should be used when DNR proposes condemnation of school trust land. Without additional clarification, there is potential for stalemates or delays in cases where DNR and OSTL have disagreements.

Initiating Real Estate Projects

The 2016 Legislature gave OSTL, among its other duties, the authority to “evaluate and initiate real estate development projects on school trust lands” with the advice of the LPSFC.¹⁰¹ The added responsibility came with a one-time \$250,000 appropriation.¹⁰²

Although state law allows the Office of School Trust Lands to evaluate and initiate real estate projects on trust lands, the law does not require the office to consult with, or obtain the approval of, the Department of Natural Resources.

OSTL’s ability to *evaluate* potential projects is in keeping with its advisory role. However, its authority to *initiate* real estate development projects on school trust lands without DNR’s prior approval appears to conflict with the department’s authority to manage the lands.

Staff at both DNR and OSTL told us that this provision has not presented any problems. OSTL has not initiated any real estate projects, and the 2019 Legislature redirected the funding OSTL had received for this purpose to OSTL’s long-term planning activities.¹⁰³ However, a DNR official told us the lack of clarity regarding this statute allows for

¹⁰¹ *Laws of Minnesota* 2016, chapter 189, art. 7, sec. 14.

¹⁰² *Laws of Minnesota* 2016, chapter 189, art. 3, sec. 6. In a similar vein, the 2017 Legislature made a one-time appropriation of \$500,000 to OSTL to “initiate the private sale of surplus school trust lands in the Boundary Waters Canoe Area Wilderness. *Laws of Minnesota* 2017, chapter 93, art. 1, sec. 9(b).

¹⁰³ *Laws of Minnesota* 2019, First Special Session, chapter 4, art. 1, sec. 11.

potential conflict, and an OSTL official told us that the assignment of this function in statute puts OSTL “in an awkward position.”

RECOMMENDATION

The Legislature should amend statutes to require the Office of School Trust Lands to obtain approval from the Department of Natural Resources before initiating real estate projects on school trust lands.

State law requires OSTL to receive advice from the Legislative Permanent School Fund Commission when it initiates real estate development projects. Given DNR’s statutory responsibility to manage school trust lands, we think OSTL should also be required by law to get DNR’s approval before initiating real estate projects. Alternatively, the assignment to OSTL of real estate initiation duties could be repealed from statute, leaving this responsibility to the manager of school trust lands (DNR).

Compliance Issues

This section highlights several issues related to compliance with school trust land statutes that we think the Legislature should consider.

Legislative Permanent School Fund Commission

The Legislature created the LPSFC to advise DNR and OSTL on the management of school trust lands and review legislation that may affect the lands. While many of the commission’s responsibilities are similar to those of its predecessor, the 2012 Legislature specifically (1) required the commission to review legislation affecting school trust lands and (2) expanded the previous committee’s authority by allowing (but not requiring) the new commission to make recommendations in its annual report about the asset allocation of the Permanent School Fund.¹⁰⁴

The Legislative Permanent School Fund Commission has not submitted statutorily required annual reports to the Legislature since the commission’s formation in 2013.

State law requires the commission to submit a report to the Legislature by January 15 of each year with recommendations for managing school trust lands in a way that will secure long-term economic return for the Permanent School Fund.¹⁰⁵ In our opinion, one of the LPSFC’s most important responsibilities is to make recommendations to the full Legislature. By itself, the commission has no authority to change how school trust lands or the Permanent School Fund are managed. These policy and management

¹⁰⁴ *Laws of Minnesota* 2012, chapter 249, sec. 7, codified as *Minnesota Statutes* 2019, 127A.30, subds. 1(a) and 2(5).

¹⁰⁵ *Minnesota Statutes* 2019, 127A.30, subd. 2.

decisions rest with DNR, the Department of Management and Budget, the State Board of Investment, and the full Legislature.

It is no small task for the commission to be aware of all proposed legislation that could affect school trust lands. Bills affecting trust lands do not have to be referred to the commission before being considered by standing committees. In addition, there is no requirement that the commission be notified when bills affecting school trust lands or the Permanent School Fund are introduced. If large bills contain only small provisions related to school trust lands, or if bills only indirectly affect school trust lands, it may be challenging for the commission to identify all pertinent bills. During the 2017-2018 legislative sessions, for example, 467 bills were referred to the House Environment and Natural Resources Policy and Finance Committee, and 237 were referred to the House Education Finance Committee. Although the commission has discussed proposed legislation at its hearings, it has not developed a process that systematically tracks relevant bills in the legislative process. Further, our review of meeting minutes show that the commission has seldom taken an official position on the bills or issues discussed.

The Legislative Permanent School Fund Commission's ability to do this work is limited by its minimal staffing. Since the commission's creation in 2013, the Legislative Coordinating Commission (LCC) has provided part-time staff support. Staff's role is largely administrative—preparing meeting materials for members, recording meetings, and writing meeting minutes. Staff do not routinely monitor legislation related to school trust lands, and—as noted above—have not prepared an annual report. The staff assigned to the commission do not have specialized expertise in school trust lands or education finance.

The Legislative Permanent School Fund Commission has not reviewed land exchanges involving school trust lands, contrary to state law.

State law allows for land exchanges involving “Class A” land—that is state-owned land that is administered or controlled by DNR.¹⁰⁶ For proposed exchanges of school trust land with other Class A land, the law requires the Legislative Permanent School Fund Commission to provide independent legal review of these transactions.¹⁰⁷ However, a DNR official told us that DNR has rarely provided that commission with information on school trust land exchanges in recent years because the commission is not equipped to conduct such reviews. According to DNR, previous legislators serving on the commission directed DNR in past years not to send this information to the commission. The commission has not had an attorney on staff nor funding to pay for independent legal counsel.

¹⁰⁶ *Minnesota Statutes* 2019, 94.343.

¹⁰⁷ *Minnesota Statutes* 2019, 94.342, subd. 5.

RECOMMENDATION

The Legislature should authorize the Legislative Permanent School Fund Commission to have at least one staff person knowledgeable in school trust land issues, preferably with legal expertise.

In our view, LPSFC needs at least one staff person to fulfill its statutory duties.¹⁰⁸ At a minimum, LPSFC staff should (1) monitor legislation affecting school trust lands and the revenue they generate, (2) review land exchanges involving school trust land, and (3) prepare the commission's annual report to the Legislature. An annual report from the commission could help the Legislature's relevant policy and finance committees to be aware of recommendations the commission has taken on issues affecting school trust lands.¹⁰⁹

The commission's staffing could be provided in one of three ways. First, the Legislature could expand LPSFC's authority to hire its own staff and appropriate the necessary funds for it to do so. Several legislative commissions hire their own staff to work full time on commission issues and responsibilities. Second, the Legislature could make OSTL part of the legislative branch, rather than the executive branch, and have it staff the LPSFC. However, such a change would require many revisions to state law, given the executive branch duties OSTL has performed since it was created in law by the 2012 Legislature.¹¹⁰ Third, the LPSFC could arrange to use existing staff from the House or Senate—such as nonpartisan research or legal staff, or a standing committee administrator—to supplement its staff; this is currently done with the legislative commissions on Data Practices and Metropolitan Government. However, it may be challenging to get the time of those staff during the legislative session, which is when the commission has been most active.

If the Legislature does not make arrangements for LPSFC to be staffed to perform its statutorily assigned duties, then state law should be amended to pare back those duties. However, eliminating key duties from the LPSFC enabling statutes may be contrary to the intent of the 2012 Legislature's actions, which were supposed to strengthen the Legislature's oversight of school trust lands.

¹⁰⁸ Our 1998 evaluation of school trust land had a similar recommendation. Office of the Legislative Auditor, Program Evaluation Division, *School Trust Land* (St. Paul, 1998), 73. At that time, we recommended that the Legislature should use Permanent School Fund resources to fund a position, full or part time, in the Department of Finance (now the Department of Management and Budget) to staff the Permanent School Fund Advisory Committee. When the 2012 Legislature changed the composition and duties of the committee (and called it a commission), it provided the commission with funding too limited to pay for full-time staff.

¹⁰⁹ The LPSFC's website contains written meeting minutes that identify specific actions the commission has taken (<https://www.lcc.leg.mn/lpsfc/#>).

¹¹⁰ For example, if the Legislature were to make OSTL a legislative agency, it would need to amend *Minnesota Statutes* 2019, 127A.353, subd. 4(b)(6), which says that OSTL has authority to serve as temporary trustee of school trust lands subject to proposed or active eminent domain proceedings. In such instances, perhaps the Legislature could make the Department of Management and Budget or Department of Administration the temporary trustee.

Department of Natural Resources

In this section, we discuss several legal compliance issues that relate to DNR. These issues pertain to: (1) a requirement for DNR to sell or exchange surplus land to benefit the Permanent School Fund, (2) a requirement for DNR to use its biennial school trust land reports to update the Legislature on school trust lands that cannot generate revenue, and (3) a requirement for DNR to produce legislative reports on school trust lands every six months, contrary to DNR's longstanding practice.

Surplus Land Sales or Exchanges

Legislation passed in 2015 (and amended in 2016) required DNR to sell or exchange surplus state lands to benefit the Permanent School Fund.¹¹¹ Specifically, the law required DNR to sell or exchange at least \$3 million worth of nontrust lands by June 30, 2017. In the case of land sales, the law said that DNR must place 90 percent of the sale proceeds in the school trust lands account “to extinguish the school trust interest... on school trust lands that have public water access sites or old growth forests located on them.”¹¹²

DNR did not sell or exchange the required amount of state-owned land by the Legislature's deadline, and the proceeds of DNR's sales have not yet benefited Minnesota schools.

Between fiscal years 2016 and 2020, DNR sold about 169 acres of state-owned land pursuant to the legislation described above. After subtracting the costs for these sales, the sale proceeds totaled about \$687,000. During this time, DNR did not conduct any land exchanges pursuant to this legislation. Thus, as of early 2020—well past the deadline of June 30, 2017—DNR has not come close to complying with the \$3 million in land sales or exchanges required by state law.¹¹³ Furthermore, the Permanent School Fund has not yet benefitted from DNR's land sales; DNR still has the sale proceeds in one of its accounts.

Initially, DNR told us that it intended to use the proceeds from completed land sales to condemn the trust interest in certain public water access sites or old growth forests as funding and staff resources allow. The department said, “At this time, the department is using its available funding and staff resources to first complete the land exchanges for the [public water access] sites located on school trust land.”¹¹⁴ DNR said that its work on land exchanges was not completed by the Legislature's 2017 deadline because (1) DNR needed to conduct ground assessments and land surveys to determine the

¹¹¹ *Laws of Minnesota* 2015, First Special Session, chapter 4, art. 4, sec. 131; and *Laws of Minnesota* 2016, chapter 189, art. 3, sec. 43.

¹¹² *Laws of Minnesota* 2016, chapter 189, art. 3, sec. 43.

¹¹³ DNR told us that it proved difficult to meet the statutory \$3 million requirement because the law directed DNR to sell only certain types of land not classified as “units” under the Outdoor Recreation Act (*Minnesota Statutes* 2019, 86A.01 and 86A.05). DNR said it had already sold most of the marketable land not classified as units in response to earlier legislative requirements.

¹¹⁴ Sarah Strommen, Commissioner, Department of Natural Resources, Letter to Joel Alter, Office of the Legislative Auditor, February 28, 2020, 4.

boundaries of the public water access sites to be exchanged, (2) appraisals for the lands subject to the exchanges required 6 to 12 months, and (3) funding for costs related to the land exchanges had not been appropriated or otherwise identified.¹¹⁵ In May 2020, DNR told us that it had decided to reprioritize its work, and that it intends to use the more than \$600,000 in proceeds from its land sales to condemn the trust interest in certain public water access sites, rather than first completing the public water access site exchanges it planned to pursue.¹¹⁶

RECOMMENDATION

The Department of Natural Resources should expeditiously use the proceeds of its legislatively required land sales to condemn and sell certain school trust lands that cannot generate revenue, thereby generating revenue for the Permanent School Fund.

DNR did not sell or exchange as much state-owned land as the Legislature required. Furthermore, it is now three years past the Legislature's sales deadline for these properties, and the proceeds of the sales have not yet been used to benefit Minnesota public schools. DNR has more than \$600,000 in proceeds from these sales, and it should use these dollars to condemn school trust lands that cannot generate revenue.

Updates on Lands Prohibited from Generating Revenue

Legislation adopted in 2012 required that DNR (1) inventory and identify all school trust lands prohibited from generating revenue due to a restrictive designation or policy provision and (2) develop a plan to compensate the Permanent School Fund for the lost revenue or manage the lands to produce revenue.¹¹⁷ This initial inventory and plan were to be completed by December 31, 2013, in a biennial report to the Legislature and LPSFC.

In response to this requirement, DNR's 2013 biennial report estimated that \$50 to \$100 million would be needed from the Legislature to compensate the Permanent School Fund. For example, the 2013 report identified the following categories of lands subject to policies or designations that may restrict their ability to generate revenue: 17,800 acres of land designated as old-growth forest, 7,000 acres of land designated as

¹¹⁵ The 6 to 12 month appraisal process included time to scope, bid, and complete the appraisals. This time frame reflected the fact that the lands included multiple parcels and were located in counties throughout the state.

¹¹⁶ The legislation that required the DNR land sales or exchanges said that the Office of School Trust Lands would take the lead in identifying possible state-owned lands for this process. *Laws of Minnesota* 2015, First Special Session, chapter 4, art. 4, sec. 131, amended by *Laws of Minnesota* 2016, chapter 189, art. 3, sec. 43, said: "The school trust lands director shall identify, in consultation with the commissioner of natural resources, at least \$5,000,000 in lands suitable for sale or exchange with school trust lands." OSTL contends that DNR identified about 700 acres it was willing to sell—from an initial list DNR developed of more than 43,000 possible acres—without consulting OSTL. DNR said it initiated this process in 2015 because it had access to land records and because Governor Dayton did not appoint the OSTL director until September 2015. DNR said it shared a list of possible lands to sell with OSTL in March 2016, and DNR said it believes this met the statutory requirement for consultation.

¹¹⁷ *Laws of Minnesota* 2012, chapter 249, sec. 4, codified as *Minnesota Statutes* 2019, 84.027, subds. 18(b) and 18(c).

native prairie conservation sites, 207 public water access sites, and over 16,000 acres designated as having high and outstanding biodiversity.¹¹⁸

Contrary to what the law requires, the department provided limited updates in biennial school trust land reports issued in 2016 and 2018 regarding the department’s efforts to maximize long-term economic return from lands prohibited from generating revenue.

In addition to requiring that DNR prepare an initial inventory and plan by the end of 2013, the law required that DNR’s subsequent biennial reports on school trust land management “include a status report of the commissioner’s progress in maximizing the long-term economic return on lands identified in the 2013 report.”¹¹⁹

After the 2013 inventory, DNR’s next two biennial reports—issued in 2016 and 2018—provided limited information on department efforts to improve the revenue potential of these lands. The reports provided some detail on the department’s efforts to exchange school trust lands in the Boundary Waters Canoe Area Wilderness for land able to generate revenue.¹²⁰ However, the reports did not give the Legislature clear summaries showing changes in total acreage or management practices regarding school trust land subject to revenue-generating restrictions. In contrast, a draft version we reviewed of the biennial report DNR intends to issue in 2020 had a clearer summary of the status of these lands.¹²¹

Aside from the biennial reports, DNR produced two reports—both issued in 2017—that provided additional information on how the Permanent School Fund could be compensated for these lands—through condemnation, acquisition, or plans to manage land for long-term revenue generation.¹²² Together, those two reports estimated that about \$59 million would be needed to compensate the Permanent School Fund for three categories of school trust land affected by limits on revenue generation.¹²³

One reason it has been important to provide the Legislature with ongoing updates on school trust land compensation is because of the statutes’ deadline for action. The law says: “By July 1, 2018, the permanent school fund must be compensated for all school

¹¹⁸ Department of Natural Resources, *Minnesota’s School Trust Lands, Biennial Report, Fiscal Years 2012-2013* (St. Paul, December 2013), 6. The report said its total compensation estimate “does not include future compensation that may be necessary for future policies or designations to preserve natural resource or recreation values that prohibit long-term school trust revenue generation” (p. 66).

¹¹⁹ *Laws of Minnesota* 2012, chapter 249, sec. 4, codified as *Minnesota Statutes* 2019, 84.027, subd. 18(c).

¹²⁰ Department of Natural Resources, *Minnesota’s School Trust Lands Biennial Report Fiscal Years 2014-2015* (St. Paul, 2016), 12; and *Minnesota’s School Trust Lands Biennial Report Fiscal Years 2016-2017* (St. Paul, 2018), 29-30.

¹²¹ Department of Natural Resources, *Minnesota’s School Trust Lands, [Fiscal Years] 2018-2019 Biennial Report, Draft Version* (St. Paul, May 2020), unpublished. As of mid-May 2020, this draft report was being reviewed by DNR management and had not been approved for public issuance.

¹²² Department of Natural Resources, *Minnesota’s School Trust Lands Valuation Report: Progress as of December 31, 2016* (St. Paul, January 2017); and *School Trust Lands Valuation Report: Presented to the Legislative Permanent School Fund Commission* (St. Paul, August 2017).

¹²³ The reports did not provide estimates for several other categories of land.

trust lands included under a designation or policy provision that prohibits long-term economic return.”¹²⁴ As noted earlier, however, the Legislature did not provide for compensation by the statutory deadline. The law also says: “Any uncompensated designation or policy provision restrictions on the long-term economic return on school trust lands remaining after July 1, 2018, must be compiled and submitted [by DNR] to the Legislative Permanent School Fund Commission for review.”¹²⁵ However, DNR did not present such a compilation to the commission prior to 2020.¹²⁶

RECOMMENDATION

The Department of Natural Resources should report in its biennial reports about its progress in (1) maximizing the long-term economic return on trust lands unable to generate revenue due to policy or statutory designation and (2) obtaining funds from the Legislature or elsewhere to compensate the Permanent School Fund for these lands.

Minnesota statutes explicitly require that DNR’s biennial reports provide “status reports” regarding school trust lands restricted from generating revenue.¹²⁷ Although DNR’s biennial reports have not ignored this topic, it has been difficult to use some of these reports to assess what progress has occurred. Some DNR reports have estimated how much the Permanent School Fund would have to be compensated for certain categories of school trust lands that do not generate revenue, but the biennial reports should clearly indicate the extent of any changes that have occurred since DNR’s 2013 school trust land inventory—in terms of land condemned or managed in different ways. As recommended earlier, we also think DNR should report better measures of its performance in managing school trust lands.

Biannual vs. Biennial Reports

In our office’s 1998 evaluation of school trust lands, we recommended that the Legislature require DNR to develop biennial reports on school trust lands management.¹²⁸ DNR began preparing biennial reports at its own initiative in 2002, and the 2008 Legislature adopted a statutory reporting requirement for DNR.¹²⁹

Minnesota statutes require the Department of Natural Resources to issue biannual rather than biennial reports on school trust fund management.

¹²⁴ *Minnesota Statutes* 2019, 84.027, subd. 18(c).

¹²⁵ *Ibid.*

¹²⁶ DNR told us that after it did not issue the legislatively required report on uncompensated designation or policy provision restrictions in early 2019, it decided to wait to provide that information until its next biennial school trust lands report. As noted previously, DNR expects to issue its biennial report for fiscal years 2018-2019 during 2020.

¹²⁷ *Minnesota Statutes* 2019, 84.027, subd. 18(c).

¹²⁸ Office of the Legislative Auditor, Program Evaluation Division, *School Trust Land* (St. Paul, 1998), 74.

¹²⁹ *Laws of Minnesota* 2008, chapter 357, sec. 2, codified as *Minnesota Statutes* 2019, 84.027, subd. 18(a).

“Biannual” means twice a year, while “biennial” means once every two years. Although legislation adopted in 2008 requires the department to report “biannually,” DNR has issued only one report (in June 2009) that varied from the biennial time frame. The department resumed biennial reporting in December 2009, issuing a report that covered the previous two fiscal years; however, this and subsequent reports were called “biannual” reports.

RECOMMENDATION

The Legislature should amend state law to require the Department of Natural Resources to prepare a *biennial* rather than a *biannual* report.

A biennial report would align with DNR’s current practice, which it began in 2002 to comply with the 1998 OLA recommendation.¹³⁰ In our view, a report every two years would be sufficient. Unless the Legislature wishes to see more frequent reports, it should revise the statutory language to require “biennial” reports on school trust lands. This might address possible confusion among persons expecting to see more frequent reports, based on the current statutory language. DNR proposed legislation in 2020 to make a change in statutes that is consistent with this recommendation, and this legislation was still under consideration by the Legislature as of mid-May 2020.

¹³⁰ Department of Natural Resources, *Minnesota’s School Trust Lands Biennial Report for Fiscal Years 2000-2001* (St. Paul, 2002), 2; and Office of the Legislative Auditor, Program Evaluation Division, *School Trust Land* (St. Paul, 1998), 74.

List of Recommendations

- The Department of Natural Resources—with input from the Office of School Trust Lands—should develop a comprehensive set of measures to help assess the management of school trust lands and the revenue they generate. (p. 16)
- Consistent with state law, the Legislature should compensate the Permanent School Fund for instances in which state policies or legislative actions have prohibited school trust lands from generating revenue. (p. 20)
- The Legislature should consider clarifying in law:
 - Whether OSTL’s authority to act as a temporary trustee of school trust lands is mandatory in cases involving school trust land condemnations.
 - Procedures by which land valuations or appraisals for school trust land condemnation must be obtained, and whether those appraisals or valuations must be by parties other than DNR.
 - How disagreements between OSTL and DNR in the school trust land condemnation process should be resolved. (p. 26)
- The Legislature should amend statutes to require the Office of School Trust Lands to obtain approval from the Department of Natural Resources before initiating real estate projects on school trust lands. (p. 27)
- The Legislature should authorize the Legislative Permanent School Fund Commission to have at least one staff person knowledgeable in school trust land issues, preferably with legal expertise. (p. 29)
- The Department of Natural Resources should expeditiously use the proceeds of its legislatively required land sales to condemn and sell certain school trust lands that cannot generate revenue, thereby generating revenue for the Permanent School Fund. (p. 31)
- The Department of Natural Resources should report in its biennial reports about its progress in (1) maximizing the long-term economic return on trust lands unable to generate revenue due to policy or statutory designation and (2) obtaining funds from the Legislature or elsewhere to compensate the Permanent School Fund for these lands. (p. 33)
- The Legislature should amend state law to require the Department of Natural Resources to prepare a *biennial* rather than a *biannual* report. (p. 34)



May 19, 2020

Joel Alter, Director of Special Reviews
Office of the Legislative Auditor
140 Centennial Building
658 Cedar Street St. Paul, MN 55155

Via email

Dear Mr. Alter:

Thank you for the opportunity to review and comment on recommendations found in your office's report entitled *Special Review: School Trust Land Management and Oversight*. We appreciate and value the professional review conducted by staff from the Office of the Legislative Auditor (OLA), and the consideration you have given to our comments on an earlier draft of the report. The Department of Natural Resources (DNR), as trustee of state-owned school trust lands, takes our responsibility seriously and works diligently to enhance the school trust portfolio for the benefit of the beneficiaries of the trust, Minnesota's public schools. We thank your office for the effort put forth to describe the complexities surrounding school trust land management, evaluate the actions of the various executive and legislative fiduciaries, and identify potential areas for improvement.

The statements below provide our response to each DNR-related recommendation in the report.

Agency response to DNR-related recommendations

Recommendation: *The Department of Natural Resources—with input from the Office of School Trust Lands—should develop a comprehensive set of measures to help assess the management of school trust lands and the revenue they generate.*

DNR Response: The DNR agrees with this recommendation to the extent that the DNR does not currently have a comprehensive set of goals specific to school trust lands. The DNR does maintain goals and measures that span across all types of state lands, including some limited specific goals for school trust lands (e.g., a “cords offered” target for school trust lands within the department’s sustainable timber harvest goals). As mentioned in your report, the DNR is working in conjunction with the Office of School Trust Lands (OSTL) and a real estate investment advisor, Callan, LLC, to develop an overarching school trust land Asset Management Plan that will serve as a 25-year framework for school trust lands management. The Asset Management Plan, and corresponding asset business plans, will establish performance metrics, or recommendations for performance metrics, that will aid in the assessment of school trust lands management.

DNR agrees with the need for performance metrics and measures for management of school trust lands.

However, we do want to underscore that measures of mineral-related performance are largely out of DNR's control. For example, global conditions affect the domestic markets in steel and iron ore, as well as the investment market for non-ferrous exploration. Domestic markets are driven by the mix of ore ownership that leaseholders are mining at any particular time. Similarly, external factors strongly influence the performance of the timber and real estate portions of the portfolio. These exogenous factors include general economic forces and sector-specific conditions and trends. Financial metrics and performance measures need to be viewed within the context of these external factors and with regard to any available benchmarks.

Recommendation: *The Legislature should consider clarifying in law:*

- *Whether OSTL's authority to act as a temporary trustee of school trust lands is mandatory in cases involving school trust land condemnations;*
- *Procedures by which land valuations or appraisals for school trust land condemnation must be obtained, and whether those appraisals or valuations must be by parties other than the DNR; and*
- *How disagreements between OSTL and DNR in the school trust land condemnation process should be resolved.*

DNR Response: The DNR agrees with this recommendation. DNR and OSTL have been collaborating on a new standard operating procedure for condemnation transactions and support further clarifying roles in Minnesota statutes. The DNR would like to respond to OSTL's comment that outside experts conducting appraisals may "prevent the appearance of a conflict of interest" (page 23). The DNR disputes that there is an appearance of or an actual conflict of interest when DNR staff perform appraisals or minimal valuations of school trust land. All DNR staff, including our appraisers, have a fiduciary responsibility to the trust. Our appraisers also have the standard duties of professional responsibility common to all licensed professional appraisers. There is no general conflict, actual or perceived, in this situation. Any DNR appraiser would, of course, have a duty to raise and recuse themselves from a conflict of interest based on the specific facts surrounding an individual appraisal and transaction.

The OSTL's position that full appraisals should be conducted for all school trust condemnations, without strong evidence as to the benefit, conflicts with the DNR's duty under to Minn. Stat., sec. 84.027, subd. 18(a)(2) to "reduce the management expenditures of school trust lands and maximize the revenues deposited in the permanent school trust fund".

Recommendation: *The Legislature should amend statutes to require the Office of School Trust Lands to obtain approval from the Department of Natural Resources before initiating real estate projects on school trust lands.*

DNR Response: The DNR agrees with this recommendation and supports further clarifying DNR and OSTL roles regarding evaluating and initiating real estate projects on trust lands.

Recommendation: *The Department of Natural Resources should expeditiously use the proceeds of its legislatively required land sales to condemn and sell certain school trust lands that cannot generate revenue, thereby generating revenue for the Permanent School Fund.*

DNR Response: The DNR agrees with this recommendation. As mentioned in your report, we plan to reprioritize our work to first use the \$687,000 in proceeds from land sales completed under this legislative directive to buy out (i.e. condemn) the trust interest in prioritized Public Water Access (PWA) sites, instead of first completing additional PWA site exchanges, as previously planned.

Recommendation: *The Department of Natural Resources should report in its biennial reports about its progress in (1) maximizing the long-term economic return on trust lands unable to generate revenue due to policy or statutory designation and (2) obtaining funds from the Legislature or elsewhere to compensate the Permanent School Fund for these lands.*

DNR Response: The DNR agrees with this recommendation. However, we also want to note that, while these updates have been limited within the biennial school trust land reports, efforts to maximize long-term economic returns and compensate the trust where statute or policy inhibit returns were covered extensively in two separate “compensation reports” that were provided to meet the intent of the statutory requirements (see [Minnesota's School Trust Valuation Report. Progress as of December 31, 2016](#) and [Minnesota's School Trust Valuation Report. Final Update as of August 2017](#)).

We recognize that structuring these compensation updates as separate reports reduced clarity in the department’s progress on these efforts and did not clearly meet the intent of the law. We have since restructured the biennial report to integrate compensation reporting directly into the biennial reports. The forthcoming 2020 school trust land management biennial report, for fiscal years 2018 and 2019, will reflect this change. In addition, the 2020 biennial report will also summarize approximately ten years of DNR requests to obtain funds from the Legislature or elsewhere to compensate the Permanent School Fund.

Recommendation: *The Legislature should amend state law to require the Department of Natural Resources to prepare a biennial rather than biannual report.*

DNR Response: The DNR agrees with this recommendation. As mentioned in your report, Section 14 of the DNR’s 2020 policy bill ([HF3657/SF3842](#)) includes this change to the reporting requirement.

Thank you again for your thorough review and for the opportunity to comment on the report. If you have questions regarding these comments, please contact Bob Meier, Assistant Commissioner, at (651) 259-5024.

Sincerely,



Sarah Strommen
Commissioner

CC: Jess Richards, Assistant Commissioner
Bob Meier, Assistant Commissioner
Trina Zieman, Land Asset and School Trust Administrator



May 18, 2020

Mr. James Nobles, Legislative Auditor
Office of the Legislative Auditor
Room 140 Centennial Office Building
685 Cedar Street
St. Paul, Minnesota 55155-1603

Re: Special Review – School Trust Land Management

Dear Mr. Nobles:

The Office of School Trust Lands (OSTL) recognizes the importance of the special review completed by your office regarding the State's approach to the management of school trust lands since 2012. We find the report accurately depicts Minnesota's current school trust management structure, and offers valuable recommendations to further the goals of Minnesota's school trust lands.

We agree with your report's findings for the critical need to develop performance metrics in order to measure the school trust's portfolio performance and potential. As noted in your report, OSTL and the Department of Natural Resources (DNR) are working with an institutional investment consultant to develop an asset management plan to provide a 25-year framework for school trust lands management. Performance measures will be a key component of the asset management plan in order to direct the growth of the school trust lands asset portfolio.

Your special review also offers valuable insight into the initial difficulties encountered by both the executive and legislative branches about Minnesota's new trust lands management structure. The report highlights two areas – condemnations and real estate development projects – in which OSTL can work more effectively with DNR. We will continue to develop efficient processes and procedures around these and other trust land management issues in order to foster respectful cooperation and robust collaboration.

The report also recommends that the legislature appropriate the needed funds to meet the statutory requirement to compensate the Permanent School Fund for past prohibitive policies and designations on school trust lands. OSTL, DNR and our stakeholders have worked with Permanent School Fund Commission members to introduce a number of legislative initiatives to fulfill this legislative mandate, and will continue to advocate for compensation moving forward.

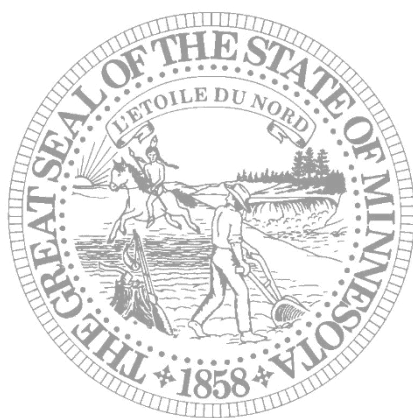
The Office of School Trust Lands supports the recommendations outlined in your report, and will work with the DNR and Permanent School Fund Commission to incorporate them into our strategic guidance, legislative, and advisory roles. As trustees, we will continue to act in the best interest of Minnesota's school trust beneficiaries – the state's 865,000 public school students.

Sincerely,



Aaron M. Vande Linde
Director







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