The Permanent School Fund — Background and Issues

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

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

A Permanent University Fund also exists separately from the PSF.

Land Was Placed in a School Trust When Minnesota Became a State

Lands in the PSF trust came from three major sources.¹

1. A total of 2,995,628 acres of school lands was granted to the state in the Enabling (Statehood) Act of 1857. This land consisted of sections 16 and 36 of most townships, and lands selected in lieu of those sections where sections 16 or 36 were no longer available.

2. About 4,770,000 acres of swamp or overflowed lands were granted to the state in 1860. Most of this acreage was sold or granted away, but a 1962 constitutional amendment combined the remaining 1,560,000 acres with the PSF trust lands.

3. About 500,000 acres were granted to the state as internal improvement lands in 1866. All but 6,677 acres of this land was sold, and a 1974 constitutional amendment transferred all remaining land, cash, and investments of the internal improvement land fund to the PSF.

Much of this land was sold in the years following statehood. Any PSF land sale must be by means of a public auction². Beginning in the early 1900’s, the policy of selling trust fund land was modified and various types of public land were withdrawn from sale.

¹March 1983, Permanent School Fund Management Report, DNR.

²Minnesota Constitution Article XI, Section 8.
Of the 8.3 million acres of lands granted to the state under the three programs, 2,510,000 acres remain in the PSF. Most of these remaining lands are in the northern part of the state; more than 85 percent is found in Koochiching, St. Louis, Itasca, Lake, Cass, Aitkin and Cook counties. Of the 2.5 million acres, 1.8 million acres are in DNR management units as follows (the numbers for management areas will add to a number greater than the total because some land parcels are in more than one management area):

<table>
<thead>
<tr>
<th>Management Area</th>
<th>Acres</th>
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<tr>
<td>State Forests including Campgrounds</td>
<td>1,737,123</td>
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<tr>
<td>Wildlife Management Areas</td>
<td>85,681</td>
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<tr>
<td>Scientific &amp; Natural Areas</td>
<td>54,052</td>
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<tr>
<td>State Parks</td>
<td>5,795</td>
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<tr>
<td>Riverways</td>
<td>756</td>
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<tr>
<td>Water Access</td>
<td>1,321</td>
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</table>

DNR manages an additional 706,800 acres outside established management areas. These acres are primarily forestry lands but also include mineral, agricultural and lakeshore lands and other smaller categories. Besides the 2.5 million acres of land, the PSF also includes the severed mineral rights only for another almost one million acres.³

**Lands in the PSF Trust are Managed by DNR**

The DNR’s goal for management of PSF lands is “to secure the maximum long-term economic return from the school as provided in state law.”⁴

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

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

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

³Data from March 1983, Permanent School Fund Management Report, DNR and updated by DNR in October, 1996.

⁴March 1983, Permanent School Fund Management Report, DNR.
There are still 541 lakeshore lots on PSF land being leased by DNR. State law requires that the lease rate be 5 percent of the appraised value of the lakeshore lots.\(^5\) The DNR has finally complete lakeshore lease rules (the law required that rules be adopted by July 1, 1986) that outline an appraisal and appeal process for determining lease rates on leased lots. Now that the new rules are in place, DNR is implementing a three-year phase-in new lease rates.\(^6\)

Approximately 50 percent of the state-administered wild rice leases are on PSF land. Discussions are ongoing about how to promote wild rice operations and how to provide income to the PSF. Among the options are exchanging, or condemning and selling, the trust interest in the land.\(^7\)

Land is also leased for the removal of sand and gravel.\(^8\) DNR administers these leases as well.

DNR incurs considerable costs in the management, administration and protection of PSF land. State law allows the DNR to deduct the costs of protection, improvement, management and administration of state forest trust fund lands and construction and improvement of forest roads from forestry proceeds earned by those lands.\(^9\) Costs included are fire suppression protection, timber sale preparation, timber regeneration, law enforcement, insect and disease protection, soil survey and general office operations.

The table shows gross forestry receipts on PSF lands and the amount deducted from those proceeds for DNR expenses in recent years.\(^10\)

### Forestry Proceeds from PSF Trust Lands

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<tbody>
<tr>
<td>Total forestry receipts</td>
<td>$3,344,888</td>
<td>$3,939,460</td>
<td>$3,992,381</td>
<td>$4,832,416</td>
<td>$4,596,294</td>
<td>$5,611,475</td>
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<tr>
<td>DNR management costs</td>
<td>$3,748,701</td>
<td>$3,647,498</td>
<td>$3,692,971</td>
<td>$3,423,693</td>
<td>$3,408,234</td>
<td>$3,972,269</td>
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<tr>
<td>Amount transferred to PSF principal</td>
<td>$0</td>
<td>$291,962</td>
<td>$299,410</td>
<td>$1,408,723</td>
<td>$1,188,060</td>
<td>$1,639,206</td>
</tr>
<tr>
<td>Percent of forestry receipts transferred to PSF principal</td>
<td>0%</td>
<td>7.4%</td>
<td>7.5%</td>
<td>29.2%</td>
<td>25.8%</td>
<td>29.2%</td>
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The state general fund appropriation for the operation of the agency covers the costs that DNR incurs for management, administration and protection non-forest lands.

\(^5\)Minnesota Statutes, Section 92.46.

\(^6\)Letter from DNR Commissioner Rodney Sando to legislators dated December 3, 1996.

\(^7\)Wild rice leases are authorized in M.S. 92.501.

\(^8\)Leasing authorized in M.S. 92.50.

\(^9\)M.S. 16A.125.

\(^10\)Data from DNR certifications required under M.S. 16A.125.
The PSF Principal Must Remain Perpetual and Inviolate

The principal of the PSF must remain perpetual and inviolate forever.\textsuperscript{11} The principal of the PSF was $419,300,000 as of June 30, 1996.\textsuperscript{12} The principal is managed by the Department of Finance and invested by the SBI. Any net realized gain on the sale of investments must be added to the principal of the fund.

The Commissioner of the Department of Children, Families, and Learning is authorized to accept donations for deposit in the PSF.\textsuperscript{13}

The principal in the fund has been generated from a variety of sources. The single largest source of revenue has been proceeds from mineral sales and mineral exploration. About three-fourths of the PSF principal has been generated by rentals and royalties for leasing lands and removing minerals from PSF lands, and by the iron ore occupation tax. Timber sales have generated about 10 percent of the PSF principal. The remaining PSF principal has come from the sale of PSF land, easements from lakeshore leases, wild rice leases, agricultural leases, utility licenses and other commercial leases. Although about two-thirds of the PSF land has been sold, the sale of land has contributed less than 10 percent of the PSF principal.\textsuperscript{14}

Several legal restrictions limit the investment of the PSF principal. Any realized net capital losses must be offset against dividend income before that income can be distributed to school districts. Net interest and dividend earning are distributed in the year in which they are earned.\textsuperscript{15} These legal limits and the fiscal need to maximize interest earnings in the short term have limited the ability of the SBI to manage the PSF for long term gain. A provision in the 1995 K-12 Education Finance Bill allows equities (stocks) to be introduced into the PSF when investment earnings exceed the $32.5 million budgeted for fiscal years 1996 and 1997.\textsuperscript{16} However, the SBI reports that for fiscal year 1996, earnings were less than $32.5 million.

The SBI invests the PSF principal to produce a high, consistent level of income for the fund within the existing legal and fiscal limits. The current portfolio mix is approximately 37 percent in U.S. Government or government-sponsored treasury notes or securities, 32 percent in mortgage-related securities, and 18 percent in corporate securities. The remaining 13 percent is in cash equivalents.\textsuperscript{17}

\textsuperscript{11}Minnesota Constitution Article XI, Section 8.

\textsuperscript{12}Data from the State Board of Investment.

\textsuperscript{13}M.S. 124.08.

\textsuperscript{14}Figures are estimates based on the March 1983, Permanent School Fund Management Report, DNR.

\textsuperscript{15}M.S. 11A.16.

\textsuperscript{16}Laws of Minnesota, 1995 First Special Session, Chapter 3, Article 1, Section 57.

\textsuperscript{17}Memo from Howard Bicker, State Board of Investment to the PSF Advisory Committee, February 26, 1996
**Investment Earnings are Distributed to School Districts**

Interest earned by the investment of the PSF principal is distributed each year to school districts. This distribution is made on a per pupil unit basis as part of the foundation or general education formula allowance in the September and March state aid payments\(^\text{18}\). Because these funds are part of the general education formula, they, in effect, reduce the amount of state general fund money needed to fund the formula. This table shows amounts distributed in recent school years:\(^\text{19}\)

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<tbody>
<tr>
<td></td>
<td>$30,916,000</td>
<td>32,967,000</td>
<td>31,179,000</td>
<td>34,382,000</td>
<td>31,918,000</td>
<td>33,772,000</td>
<td>35,730,000</td>
<td>31,190,000</td>
</tr>
</tbody>
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**A Process Exists for Ongoing Review of PSF Issues**

The Legislative Audit Commission, in a report issued in 1981, pointed out several areas where management of the PSF could be improved. In response to that report, the 1982 K-12 Education Finance Bill established the Permanent School Fund Advisory Committee.\(^\text{20}\) This committee, made up of the chairs of the House and Senate Education Committees, the chairs of the House Ways and Means and Senate Finance Committees, the Commissioner of Children, Families, and Learning Department and two school superintendents, has met periodically since the summer of 1982 to review DNR management policies for PSF land and SBI management of the PSF principal. The PSF Advisory Committee is also designated, by state law, as the temporary trustee for PSF land involved in a land exchange.\(^\text{21}\)

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\(^{18}\)M.S. 124.09.

\(^{19}\)Information from the Department of Children, Families, and Learning. These numbers show the amounts paid in September and March of a particular school year (fiscal year). The payments are the investment earnings accrued at those times. The State Board of Investment would report a different number for the actual earnings in the July 1 - June 30 fiscal year.

\(^{20}\)M.S. 124.078.

\(^{21}\)M.S. 94.342, subdivision 5.