MINNESOTA
OFFICE OF SCHOOL TRUST LANDS

To: Interested parties
From: Aaron Vande Linde, Director
Date: March 30, 2023
Re: Minnesota's School Trust Lands | Asset Management Plan – Phase One

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The Minnesota Office of School Trust Lands (OSTL), in conjunction with the Minnesota Department of Natural Resources (DNR), is pleased to present Phase One of the first Asset Management Plan ("Plan") for Minnesota's school trust lands. The Plan serves as a 25-year framework for school trust lands management, as required by state law.

The goals of the 25-year framework, as defined in Minn. Stat. 127A.353, are:

1. Retain core real estate assets.
2. Increase the value of the real estate assets and the cash flow from those assets.
3. Rebalance the portfolio in assets with high performance potential and the strategic disposal of selected assets.
4. Establish priorities for management actions.
5. Balance revenue enhancement and resource stewardship.
6. Advance strategies on school trust lands to capitalize on ecosystem services markets.

OSTL contracted with the institutional investment consulting firm Callan LLC to spearhead the Plan's development. Callan has extensive experience working with other states on their trust land portfolios, including developing asset management plans.

Throughout the Plan's development, Callan and an interagency OSTL-DNR project team solicited feedback from internal and external parties involved in or impacted by school trust land management decisions. These activities included interviewing key legislators, engaging with Minnesota's Tribal nations and various stakeholders through virtual meetings and online surveys, and conducting comprehensive review sessions with DNR leadership and staff. These outreach efforts resulted in numerous additions and improvements to the Plan.

One of Callan's primary findings is that additional work is required to complete the Plan. Callan identified information gaps as well as recognized the need to undertake a number of activities to improve efficiencies and better position the school trust land assets for increased long-term revenue generation. Accordingly, Phase One of the Plan discusses those gaps and activities and offers recommendations regarding how OSTL and DNR might address them to successfully complete the Plan.

Phase One of the Plan is comprised of the following elements:

- Foundational information about school trust lands, including:
  - Their history and current land base.
  - The Permanent School Fund (PSF), its statutory goal, and governance structure.
  - Trustees' fiduciary duties, management goals, and legal requirements.
  - Current management direction.
  - Revenue, expense and management cost information as it is currently available.
- Recommended systems to improve strategic decision-making and facilitate robust management:
  - Guidelines to develop financial and natural resource management performance metrics.
  - Use of parcel ranking and land classification systems.
  - Use of asset class business plans.
- Situational and risk analysis:
  - Strengths, opportunities, constraints, challenges and risks pertaining to the portfolio.
- Recommendations

Phase Two of the Plan will address Callan's recommendations so OSTL and DNR can successfully complete and DNR can implement the Plan. To that end, we lay out each recommendation below along with our response and action plan for each.

Priority Recommendations

Priority recommendation #1: Develop a full cost accounting or allocation methodology and system.

Priority recommendation #2: Develop and operationalize a performance measurement system.

Response: OSTL and DNR support these interrelated recommendations and our response to them is combined.

We agree with Callan that a full understanding of revenue, expense and management cost information, as well as the use of performance metrics and measures, is fundamental to engaging in prudent management and assessing financial performance of the portfolio.

We envision that advancing these two recommendations will initially entail:

- Assessing options to efficiently capture the full scope of school trust lands financial information (i.e. through use of a full cost accounting or cost allocation methodology); and
- Determining the resources needed to collect and synthesize data in order to develop performance metrics.

These two steps will help determine the best approach based on ease of use, available human and financial resources, and the need for potential statutory or policy changes. OSTL and DNR would then move forward with:

- Routinely compiling and consistently tracking all revenues, expenses, management costs and appropriations attributable to managing school trust lands; and
- Developing metrics and the related data to measure financial performance as well as to determine the extent to which DNR is employing sound natural resource and conservation management principles.

Priority recommendation #3: Increase proceeds into the Permanent School Fund.

Response: OSTL and DNR support this recommendation because additional revenues grow the Permanent School Fund (PSF), which in turn increases the distributions to both current and future beneficiaries.

Callan offers four potential approaches to fulfill this recommendation; (1) diversify the minerals asset class, (2) strengthen support for new timber markets, (3) find innovative solutions to perfect legal access to inaccessible school trust lands, and (4) enter markets such as carbon trading, wetland banking mitigation and other ecosystem services. OSTL and DNR plan to pursue these identified opportunities to meet the PSF's goal of securing the maximum long-term economic return from school trust lands.

Priority recommendation #4: Adapt the portfolio to address climate change-related risks and opportunities.

Response: OSTL and DNR support this recommendation. Climate change effects will continue to impact individual school trust assets and the overall portfolio .

Callan advises OSTL and DNR assess and actively monitor the potential risks and opportunities associated with climate change, including the ecological impacts as well as the political, regulatory and technological responses that may impact the growth, productivity, or operability of the assets.

This analysis would be a part of the asset class business planning process. Asset class business plans implement the asset management plan and are more fully described below.

Priority recommendation #5: Increase understanding within DNR regarding how the agency defines and operationalizes "sound natural resource conservation and management principles".

Response: OSTL and DNR support this recommendation. DNR substantially revised and reissued its Management of School Trust Lands policy in 2019. The revision included, for the first time, DNR's definition of "sound natural resource conservation and management principles," which are not further defined in statute. DNR initiated concerted internal communication and education efforts as part of the reissue.

Callan recommends bolstering these efforts, and DNR plans to continue ongoing training and policy guideline development to help staff better understand how DNR operationalizes the statutory provision referenced above.

Additional Recommendations

In addition to the priority recommendations, Callan offers three supporting recommendations. Callan advises DNR and OSTL to focus on the priority recommendations first while recognizing that the supporting recommendations will also need to be addressed to complete the Plan.

Additional recommendation #1: Utilize a land classification system.

Response: OSTL and DNR recognize the value of such a system, since classifying school trust lands based on the current source of revenue generated on a land parcel or group of parcels and aggregating land

holdings into broad categories would help facilitate more robust management and offer additional data on economic activity. OSTL and DNR will evaluate how to best develop such a classification system for the school trust lands portfolio and identify the most practical approach to implement it.

Additional recommendation #2: Adopt a tiered parcel ranking system.

Response: This recommendation offers the flexibility to rank trust land assets based on their potential to generate net revenues and create or maintain value over a long-term time horizon. The value of such a ranking system is that it offers the ability to direct management priority given to the lands that have the most to offer the Permanent School Fund economically. OSTL and DNR intend to develop criteria to rank school trust land parcels and create a process to modify prior parcel ranking decisions. As an initial step, OSTL and DNR will analyze the benefits of a tiered ranking system taking into consideration potential impacts to on-the-ground management decisions.

Additional recommendation #3: Develop asset class business plans for each asset type.

Response: OSTL and DNR believe asset class business plans would benefit school trust land decision makers because they set forth the tactics and link on-the-ground operational management decisions with the objectives outlined in the asset management plan. They are designed to serve as "operator's manuals" and provide direction to asset managers as they implement day-to-day management decisions involving school trust lands. Additionally, they are a tool to monitor management activities, and a mechanism used to document the processes that derive management decisions. They would be informed by any existing DNR management plans that include or impact school trust lands.

OSTL and DNR are proud of what we have accomplished together to date on this important project. We look forward to collaborating on the work described above to complete the comprehensive asset management plan that will serve as a 25-year framework for managing Minnesota's school trust lands.

Sincerely,

Aaron Vande Linde
Director