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Linda McCulloch
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DATE: March 1, 2006

TO: Members of the EQC Study Subcommittee
Rep. Walter L. McNutt, Chair
Rep. Sue Dickenson, Vice Chair
Senator Greg Lind
Senator Robert Story, Jr.
Mr. Buzz Mattelin

FROM: Kathy Bramer, OPI School Trust Lands Staffer

RE: Subcommittee Request for Information on OPI Trust Land Appropriations and Trust Land Administrative Costs

Background
At their January 26, 2006 meeting, members of the EQC Study Subcommittee requested information from both the Office of Public Instruction and the Office of the Commissioner of Higher Education pertinent to questions that have arisen on the appropriateness of the trust manager's (DNRC) assessment of fees for the management of Montana's state school trust lands. OPI was asked to respond to the following questions.

Question 1. How does the OPI appropriations work – trust revenues vs. general fund – and anything the subcommittee may need to know regarding this topic.

A chart is attached to this memo that shows how the state trust lands revenue flows through OPI to become part of the Base Aid that is then distributed to schools. The chart was prepared by the Legislative Fiscal Division (LFD) to provide a trust lands revenue estimate for FY2006. It gives a clear picture of how various types of revenues, generated on Common School Trust lands, are distributed to schools through OPI.

The FY2006 estimate of distributable revenue available for Base Aid is shown in the chart as $56.85 million. This revenue flows through the Guarantee Account and offsets the total state direct aid appropriation to K-12 public schools. The annual payment, ranging from $45-$57 million, represents generally less than 10% of the total Base Aid distributed to schools. It is important to note that Base Aid to schools is limited by statutory formulas. Consequently, this contribution to the Guarantee Account does not affect the amount of Base Aid received by schools. Instead, the trust land revenue becomes the base on which the rest of the general fund appropriation is built.

The total Base Aid for schools is set by the legislature and is not affected directly by trust land revenue. Trust land revenue only represents a fraction of the total - the rest is paid by general fund dollars. Increased revenues from trust lands do not raise the overall appropriation for public schools, with one small exception.

The funding formula for revenues deposited in the Guarantee Account, described above, is not the same as the formula for distribution of timber harvest revenues. Revenues from trust land timber harvests for the first 18 million board feet in a year are also directed to the Guarantee Account. However, revenue generated from timber harvest above 18 million board feet in the same year are distributed to schools on a roughly per-student basis for the purchase of education technology and services in addition to Base Aid payments.

Question 2. Can the issue of administrative costs taken from revenues be addressed for the University System without addressing it for the Common Schools trust and vice versa?

With the exception of the Morrill Trust, there is no specific direction as to the appropriateness of taking management fees from revenues generated from activities on state trust lands. It is understood that, while legal opinions regarding the administrative fee issue may differ, there is an existing Attorney General's opinion (Attorney General Forrest Anderson - 1967), an affirmation of that opinion by Attorney General Robert Woodahl in 1970, and a letter of counsel from Attorney General Mike McGrath to Governor Brian Schweitzer in 2005, all of which affirm the current DNRC practice of deducting reasonable costs of managing the trusts on behalf of the beneficiaries.

Assigning the trustee management costs to each of the beneficiaries in the same proportion as revenue generated on their lands appears to be a reasonable and fair approach. With the exception of the Morrill Trust beneficiary, trust land beneficiaries share the cost of administering the trusts relative to revenues generated by those lands. However, since 2003, management costs associated with Morrill Trust lands have been supported by the beneficiaries of all the other trust lands. This appears to be an unfair assignment of costs that should instead be covered by a separate appropriation. This inappropriate assignment of costs has a disproportionately large financial impact on the Common School trust, which is the beneficiary of 90% of state trust lands.

It is important that the costs of managing state trust lands are assigned fairly to all of the beneficiaries. In order to accomplish this, the system for identifying and assessing management fees must be as clear and straightforward as possible. Segregating the University System trusts from the other trusts has the potential to create a complex and unworkable accounting structure.

If management costs are segregated by trust beneficiary, management time and effort must be segregated the same way – potentially very cumbersome and time-consuming. The DNRC manages activities on all state trust lands with staff in regional field offices across the state and in the central offices in Helena and Missoula. Additional record-keeping to account for individual management time and effort on each trust's land would be burdensome and could seriously compromise the ability of these land management professionals to effectively do their jobs. It is possible that trust land management costs could even increase as a result of this approach.

Assigning management costs for all state land trust beneficiaries should be consistent, reasonable, fair, and cost-effective. Assigning costs using different methods, such as by trust beneficiary, may result in costs being disproportionately assigned to one trust or another. As the largest stakeholder in trust land revenues, Common Schools could be the most adversely impacted by this approach.

If no management fees are assessed to cover the trust land management costs, it will be necessary to seek legislative approval for funding of all management activities on state trust land. This process would likely result in greater uncertainty regarding trust land management planning, funding, and resource allocation. There is no foreseeable gain for the trust beneficiaries in subjecting the trust land management cost assignment to the legislative process. The management costs can either be deducted before the revenues are deposited in the beneficiary accounts – the current practice, or the costs can be assigned indirectly by deducting from the budgets of the various beneficiaries. Either way, the assignment of trust land management costs must be done equitably for all trusts.