

COMMON SCHOOLS TRUST FUND – RELATED CONSTITUTIONAL AND STATUTORY PROVISIONS – USE OF FUNDS FOR EARLY INTERVENTION SERVICES

This memorandum discusses the allowable uses of the common schools trust fund, and whether income earned on the fund may be used to fund a Department of Human Services early intervention services program for children under 2 years old.

NORTH DAKOTA CONSTITUTION AND THE ENABLING ACT

The source of the common schools trust fund is Section 1 of Article IX of the Constitution of North Dakota. This section provides in part:

All proceeds of the public lands that have been, or may hereafter be granted by the United States for the support of the common schools in this state; all such per centum as may be granted by the United States on the sale of public lands; the proceeds of property that fall to the state by escheat; all gifts, donations, or the proceeds thereof that come to the state for support of the common schools, or not otherwise appropriated by the terms of the gift, and all other property otherwise acquired for common schools, must be and remain a perpetual trust fund for the maintenance of the common schools of the state. All property, real or personal, received by the state from whatever source, for any specific educational or charitable institution, unless otherwise designated by the donor, must be and remain a perpetual trust fund for the creation and maintenance of such institution, and may be commingled only with similar funds for the same institution. If a gift is made to an institution for a specific purpose, without designating a trustee, the gift may be placed in the institution's fund; provided that such a donation may be expended as the terms of the gift provide. Revenues earned by a perpetual trust fund must be deposited in the fund. The costs of administering a perpetual trust fund may be paid out of the fund. The perpetual trust funds must be managed to preserve their purchasing power and to maintain stable distributions to fund beneficiaries.

The common schools trust fund stems from requirements of the Enabling Act passed by Congress in February 1889, which established the states of North Dakota, South Dakota, Montana, and Washington.

Section 10 of the Enabling Act granted sections 16 and 36 in every township, or indemnity lands, to the state upon admission to the union for support of the common schools. The land was granted in trust and the terms of the trust require the state to maintain the permanency of the funds acquired through the grant. The funds are permitted to be used only for the support of all schools in the state.

Section 11 of the Enabling Act provides all lands granted to the state are to be disposed of only at public sale. The section provides for pooling money received by the state from oil and gas and other mineral leasing. Rentals on leased land, proceeds from the sale of timber and crops, interest on deferred payments on land sold, interest on funds arising from those lands, and all other actual income are available for the acquisition and construction of facilities, including the retirement of bonds authorized by law for such purposes, and for the maintenance and support of schools and institutions. Not less than 50 percent of each amount is to be deposited in the appropriate permanent fund.

Section 13 of the Enabling Act provides 5 percent of the proceeds from public lands within the state sold by the United States subsequent to statehood, after deduction of expenses, is to be paid to the state and used as a permanent fund, the interest of which only may be expended for the support of common schools within the state.

The Constitution of North Dakota provides the framework relating to the accumulation of income in the common schools trust fund.

Section 1 of Article IX of the Constitution of North Dakota provides the following money must be deposited in the common schools trust fund and used to support the common schools of the state:

- All proceeds relating to public lands granted to the state by the federal government for the support of the common schools.
- All proceeds relating to property acquired by the state through escheat.
- All gifts, donations, and other property acquired by the state for the support of the common schools.
- The proceeds of all bonuses relating to the leasing of coal, gas, oil, or other mineral interests.

Section 3 of Article IX provides the Board of University and School Lands controls the common schools trust fund, and has a fiduciary duty to manage and safeguard the trust property.

Section 5 of Article IX section provides the state must retain the mineral interests in all sales of common schools lands. Leases may be executed for the extraction and sale of the minerals.

Section 24 of Article X provides 10 percent of oil extraction tax revenue must be deposited in the common schools trust fund.

The Constitution of North Dakota also provides the requirements relating to the use of funds in the common schools trust fund.

Section 1 of Article IX provides only the interest and income, not the principal, of the trust fund may be expended.

Section 2 of Article IX provides in part:

Distributions from the common schools trust fund, together with the net proceeds of all fines for violation of state laws and all other sums which may be added thereto by law, must be faithfully used and applied each year for the benefit of the common schools of the state and no part of the fund shall ever be diverted, even temporarily, from this purpose or used for any other purpose whatever than the maintenance of common schools as provided by law.

The section also provides biennial distributions from each educational trust fund must be 10 percent of the 5-year average value of the trust assets, excluding the value of lands and minerals.

STATUTORY PROVISIONS RELATING TO DISTRIBUTIONS

North Dakota Century Code also provides guidance on the fund's distribution and methods of payment.

Section 15-01-02 provides the Board of University and School Lands has full control of:

- The selection, appraisalment, rental, sale, disposal, and management of common schools lands.
- The investment of any funds derived from the sale of common schools lands.
- The proceeds of any other property required by law to be used for the support of the common schools.

Section 15-03-05.2 provides the Board of University and School Lands may distribute only a portion of a fund's income each year. The amount distributed must be consistent with the long-term goals of providing for inflationary increases in the fund value and income stability. If the amount of income earned in a fiscal year exceeds the amount distributed during the preceding fiscal year, the board has three options for the use of the additional income:

- Distribute all or a portion of the excess income.
- Retain for distribution in future years all or a portion of the excess income, up to \$10 million.
- Add to the permanent fund all or a portion of the excess income.

Section 15-44-01 provides the state tuition fund, which is distributed to the state's public schools, consists of the net proceeds from all fines for violation of state laws, leasing of school lands, and the interest and income from the common schools trust fund.

Section 15-44-03 requires the Office of Management and Budget to certify before the third Monday in February, April, August, October, and November to the Superintendent of Public Instruction the amount of the state tuition fund. The Superintendent is required to apportion the fund among the several school districts of the state in proportion to the number of children of school age residing in each as shown by the last enumeration.

Section 15-08-01.1 also provides 50 percent of the oil and gas bonus payments on common schools lands received by the Board of University and School Lands must be apportioned and distributed among the common schools for maintenance and support based upon the student population. The remaining 50 percent of the oil and gas bonus payments as well as oil and gas royalties are deposited in the permanent trust fund.

FUND USES

Section 15-03-04 provides the board is to apply the prudent investor rule in investing the permanent funds under its control, including the common schools trust fund. The section also contains a list of legal investments in which the board may invest the funds. Those investments include first mortgages on farmlands and improvements on the farmlands to the extent the mortgages are guaranteed or insured by the United States or if not guaranteed, do not exceed 80 percent of the actual value of the property; securities which are a direct obligation of the United States; bonds or certificates of indebtedness of North Dakota; general obligation bonds of other states; loans and mortgage investments guaranteed by the United States; and other types of bonds, commercial paper, and stocks.

In the past, loans have been made from the permanent funds of the common schools trust fund to build the judicial wing of the Capitol and for the Dickinson Experiment Station. Passed in 1977, Senate Bill No. 2022 authorized the Board of University and School Lands to invest an amount not to exceed \$8 million from the permanent fund of the common schools for the construction of an office building. The bill further provided that at the end of the construction cost amortization period, which was 50 years, the title of the office building would be transferred from the permanent fund of the common schools to the state of North Dakota. The bill authorized the Board of University and School Lands to lease office space to agencies of the state and the rental received would be deposited into the permanent fund of the common schools. In 1981 the Legislative Assembly enacted House Bill No. 1006, which appropriated money out of the lands and minerals trust fund to the permanent fund of the common schools for the purpose of effecting the transfer of title to the judicial wing and state office building to the state.

In 1979 the Legislative Assembly enacted Senate Bill No. 2327, which authorized the Board of University and School Lands to invest an amount not to exceed \$2,265,000 from the permanent fund of the common schools as a loan to the Board of Higher Education to purchase a working ranch unit for the Dickinson Experiment Station. The bill provided the loan could not exceed a term of 10 years and that the amount, interest rate, and method of repayment was to be negotiated by the Board of University and School Lands and the Board of Higher Education. The Board of Higher Education was authorized to grant a security interest to the permanent fund of the common schools in the property to be acquired.

In addition, the common schools trust fund was involved in a program created by the Legislative Assembly in the early 1980s to provide low-interest loans to organizations providing community residential services to individuals with developmental disabilities. Under the loan programs, the Legislative Assembly authorized the Board of University and School Lands to invest common schools trust fund money in a loan program at the Bank of North Dakota at a specified rate of return. For the facility loan fund created by the 1983 Legislative Assembly, \$5 million from the common schools trust fund was used for the loan program at a 10.5 percent rate of return. Loans were made from the fund to developmental disability providers at a rate of 5 percent for 25 years. In 1985, the Legislative Assembly created a third developmental disability loan fund with approximately \$5 million from the common schools trust fund. Under this program, the common schools trust fund received a 12 percent rate of return and loans were made to developmental disability providers at a 10.5 percent rate and to providers of services to the chronically mentally ill and other disabled individuals at a 5 percent rate, both for 25 years. For servicing these loans, the Bank of North Dakota was authorized to deduct an annual service fee of 0.5 percent of the outstanding loan balance. The funds needed to make up for the difference in the interest rate charged to providers and the rate of return provided to the common schools trust fund on the outstanding loan balance were provided from the lands and minerals trust fund (renamed the strategic investment and improvements fund by the 2011 Legislative Assembly).

NORTH DAKOTA SUPREME COURT AND ATTORNEY GENERAL OPINIONS

In *Moses v. Baker*, 299 N.W. 315 (N.D. 1941), the North Dakota Supreme Court ruled the permanent school fund is a trust fund and it must be preserved intact. If there is any loss, the state is required to make it good.

In a 1993 opinion, the Attorney General explained only the income earned by the corpus and none of the corpus of the common schools trust fund may be spent by the Board of University and School Lands. In a 2012 opinion, the Attorney General stated the common schools trust fund consists of land granted by the United States government to the State of North Dakota for the support of the common schools. The opinion further provided North Dakota accepted the land grant "under the conditions and limitations" set out in the Enabling Act and "proceeds" from these lands "constitute permanent funds" to support "the public schools." In a 2014 opinion, the Attorney General concluded the Land Board "could not gift or grant funds" to finance capital projects "because grants deplete the fund with no possibility of a return," and would violate the terms of the permanent fund as set forth in the Enabling Act and the state constitution. The Attorney General continued to explain "past opinions indicate the Land Board could make loans without violating the constitution because loans generate returns." The Attorney General indicated the Land Board "has investment authority but must comply with the prudent investor rule and the constitutional limits of the Fund."

SUMMARY

The Enabling Act's land grant was in trust with the State as trustee to maintain the permanency of the funds and use the funds only to support and maintain the common schools. Authority was given to the Board of University and School Lands to manage and invest the assets under the control of the common schools trust fund for the purpose of producing income to support and maintain the schools of the state. Section 15-03-04 requires the board to apply the prudent investor rule when investing the permanent funds of the common schools trust fund.

Funds in the common schools trust fund have been utilized for purposes other than the support of schools, but the funds were used as investments. Loans have been authorized by the Legislative Assembly utilizing common schools trust fund income and interest, but as indicated by the North Dakota Supreme Court and the Attorney General, loans may be made utilizing those assets only if the loans generate a return on investment.

Funding an early intervention program administered by the Department of Human Services likely would not be an investment that would generate income or returns for the fund, and therefore likely would not comply with the prudent investor rule to which the Board of University and School Lands must adhere to for the benefit of the common schools. Furthermore, although actions of the Legislative Assembly are presumed to be constitutional, funding of such a program likely would not meet the requirement that trust fund assets be used to support and maintain the common schools of the state without some nexus being shown between the program and the support of the common schools.