

## LEASING OF STATE LANDS - BACKGROUND MEMORANDUM

Senate Concurrent Resolution No. 4027 (2009) (attached as an [appendix](#)) directs the Legislative Management to study the leasing of state lands. In particular, the legislative history and resolution focus on the leasing of school lands by the Land Department, generally to ranchers, at public auction for a maximum term of five years. The main concerns in the resolution and legislative history with the present practice relate to:

1. The limited term of five years for the lease.
2. The practice of leasing and not selling the land.
3. Not giving a preference to the present lessee in this bidding process.

The resolution and legislative history suggest that the term of 5 years is too short and a term of 7 years or 10 years may be more appropriate. A longer term would reduce the costs of land auctions and encourage lessees to make improvements. Improvements would be encouraged because a longer term would allow for more time to recover the cost of the improvement. The longer duration would be less of an incentive for another lessee to unfairly profit by leasing the property after an improvement to the property. In short, if a lessee does a good job of managing the pasture and making improvements, there is more competitive bidding. This is a negative incentive to make improvements. In Montana, the present lessee is given the preference of being able to meet the high bid at the auction and keep the lease. In effect, this preference is an extension of the lease.

The legislative history is silent on the reasons for studying the sale of school lands. It would appear the reasons for longer leases would be the same as they would be for sale of the land. Mainly, the sale of the land would provide for more certainty for a rancher to make improvements and manage the property. In addition, managing money instead of land would arguably be less burdensome to the Land Department.

The major arguments against and limitations on expanding the term of lease, providing a preference for the present lessee, or allowing the sale of land included:

1. The bidding process allows for the adjustment of price and the shorter the term of the lease, the more responsive the price is to the market.
2. School lands are managed to provide income for public schools and leased land provides a stable income.
3. The state constitutional provisions limiting the term of lease to five years and not providing a

preference to a person due to occupation or cultivation or improvement of any public lands by that person.

### STATE-OWNED TRUST LANDS

In 1889 Congress passed an Act to provide for the states of North Dakota, South Dakota, Montana, and Washington. This Act is commonly known as the Enabling Act. The Enabling Act divided the Dakota Territory into North Dakota and South Dakota and granted the 16<sup>th</sup> and 36<sup>th</sup> sections of land in each township to the state "for the support of common schools." In addition, the Enabling Act granted lands for the support of colleges, universities, the State Capitol, and other public institutions. The other public institutions include North Dakota Vision Services - School for the Blind, the School for the Deaf, the State Hospital, the Youth Correctional Center, and the Veterans' Home.

Generally, original grant lands are governed by Article IX of the Constitution of North Dakota, and North Dakota Century Code (NDCC) Chapters 15-04 through 15-06. Article IX, Section 3, of the Constitution of North Dakota provides in pertinent part that "[s]ubject to the provisions of this article and any law that may be passed by the legislative assembly, the board [of university and school lands] has control of the appraisement, sale, rental, and disposal of all school and university lands, and the proceeds from the sale of such lands shall be invested as provided by law." The term "original grant lands" is defined in Section 15-06-01 as "all of the public lands which heretofore have been or hereafter may be granted to the state by the United States for the support and maintenance of the common schools or for the support and maintenance of the university, the school of mines, the North Dakota youth correctional center, North Dakota state university, the school for the deaf, any normal school, or any other educational, penal, or charitable institution, and any lands which have been obtained by the state through a trade of any such lands for other lands."

The Board of University and School Lands consists of the Governor, Secretary of State, Attorney General, Superintendent of Public Instruction, and State Treasurer. Under NDCC Section 15-02-01, the board appoints a commissioner to manage the Land Department. The following table includes the land managed by the board. The land is divided into the separate trusts for which the land is managed and is divided by tracts, total acres, and types of acres.

Trust	Tracts	Total Acres	Grass	Crop	Hay	Tame
Common schools	4,278	632,392.91	576,360.04	7,724.78	3,518.37	0.00
North Dakota Vision Services - School for the Blind	30	3,481.69	3,259.49	97.30	0.00	0.00
State Capitol	67	9,994.45	9,437.64	194.30	17.00	0.00
School for the Deaf	53	4,830.44	4,104.44	335.00	57.00	0.00
Ellendale	48	4,904.17	3,872.57	371.90	107.00	0.00
Farm loan pool	15	3,714.00	1,648.83	1,950.61	0.00	0.00
State Hospital	28	2,205.73	2,025.83	58.50	30.40	0.00
Youth Correctional Center	35	3,744.42	2,608.02	674.70	149.00	0.00
Indian cultural	1	160.00	146.75	0.00	0.00	0.00
School of mines	32	3,313.81	2,472.27	362.80	203.60	0.00
North Dakota State University	108	15,117.68	12,256.61	1,191.60	676.90	0.00
Veterans' Home	24	2,753.69	2,123.61	119.00	62.00	0.00
University of North Dakota	86	8,977.98	6,759.60	1,112.43	112.24	0.00
Valley City	5	640.00	544.00	40.00	45.00	0.00
State School of Science	38	3,712.94	3,337.79	228.00	0.00	0.00
Mayville	5	640.00	423.00	49.00	76.00	0.00
Valley City/Mayville	64	6,818.76	5,669.27	355.48	13.00	0.00
Total	4,917	707,402.67	637,049.76	14,865.40	5,067.51	0.00

### SALE OF LAND

Article IX, Section 5, of the Constitution of North Dakota, provides that original grant lands may be sold at any time after the first 10 years of statehood and that the Legislative Assembly is required to provide for the sale of all school lands subject to the provisions of Article IX. The Legislative Assembly has done so in NDCC Chapter 15-06. Other constitutional provisions governing the sale of original grant lands include Article IX, Section 6, which prohibits "original grant school or institutional lands" from being sold for less than fair market value or for less than \$10 per acre. Article IX, Section 1, of the Constitution of North Dakota, requires the proceeds from the sale of original grant lands to be deposited in the common schools trust fund and all proceeds from sales and all proceeds from bonuses, or similar payments, made upon the leasing of coal, gas, oil, or any other mineral interests under, or reserved after sale of, grant lands for the common schools or institutional lands must be deposited in the appropriate permanent trust fund, which might include a trust fund for a specific educational or charitable institution.

North Dakota Century Code Chapter 15-06 sets out the appraisal, notice, manner, and terms under which original grant lands may be sold. Section 15-06-22 provides that when an offer to purchase a tract of original grant land is made to the Board of University and School Lands, the commissioner must request the county board of appraisers to appraise the tract. Because the constitution and Section 15-01-02 give the board full control over rental and sale of original grant lands, the board is empowered to choose not to entertain offers to purchase those lands. The board has adopted a policy to retain most of its land holdings. According to the board's website:

By the 1970s the Board realized that continued sales would forever deplete the trusts of their land holdings. Since 80% of the original congressional grant had been sold, a decision was made to restrict sales to small, difficult to manage tracts and to retain the remainder.

North Dakota Century Code Section 15-06-25 requires the Board of University and School Lands to publish notice of any proposed sale of a tract to be published once each week for three weeks prior to the sale in the official county newspaper where the land is located and such other newspapers as the board deems appropriate. The notice must describe the land and state the bid amount and the terms and conditions of sale. Under Section 15-06-26, the sale of the land must be at public auction to the highest bidder but not for less than the fair market value of the property.

Sale and lease of nongrant lands obtained by the Board of University and School Lands is governed by NDCC Chapter 15-07. Any nongrant lands sold must be by public auction or sealed bids, except purchases under Section 15-07-10, which allows a mortgagor or member of the mortgagor's immediate family to repurchase land lost through foreclosure.

### LEASE OF LAND

North Dakota Century Code Chapter 15-04 governs the leasing of grant lands for agricultural purposes. Agricultural leases are limited to no more than five-year terms under Article IX, Section 8, of the Constitution of North Dakota, and Section 15-04-01. Agricultural leases must be awarded to the highest bidder at public auction under Section 15-04-10, but the bid may not be less than the minimum rental set by the board after appraisal under Sections 15-04-06 and 15-04-07.

The Land Department has approximately 708,000 surface acres and approximately 632,400 acres are school lands. The Land Department has over 4,500 leases of school lands that consist of 97 percent pasture and 3 percent crop or hay. Because the land is mostly pasture, the acreage increases as one travels from the east to the west in this state. Over the last five years, over 99.5 percent of the land has been leased to farmers and ranchers.

County	Tracts	Total Acres	Rank in Total Acres	Grass	Crop	Hay
Adams	109	17,097.52	18	16,967.52	0.00	0.00
Barnes	18	2,803.32	38	1,785.61	258.00	12.00
Benson	109	11,957.28	24	8,625.83	1,331.10	218.00
Billings	205	30,927.06	5	26,380.51	51.40	0.00
Bottineau	24	3,591.94	35	2,507.00	938.20	58.00
Bowman	205	29,310.48	6	28,399.91	106.70	33.80
Burke	112	16,119.43	19	14,930.71	180.00	0.00
Burleigh	193	27,890.13	9	24,435.13	1,244.00	440.67
Cass	1	40.00	49	0.00	0.00	0.00
Cavalier	6	596.47	46	336.06	179.80	0.00
Dickey	27	3,981.51	34	3,164.01	419.50	100.00
Divide	142	20,795.84	16	19,527.40	66.50	296.00
Dunn	168	25,653.18	11	24,237.35	0.00	0.00
Eddy	84	10,274.62	26	8,690.58	303.00	398.00
Emmons	92	13,516.93	23	12,790.44	421.00	0.00
Foster	21	3,111.51	36	2,686.71	175.50	18.30
Grand Forks	8	1,274.77	43	1,274.77	0.00	0.00
Golden Valley	199	28,983.55	7	22,833.37	199.00	0.00
Grant	227	33,478.72	3	32,388.42	425.30	285.00
Griggs	13	1,741.24	41	1,161.24	342.00	95.00
Hettinger	65	9,883.69	27	9,804.65	0.00	0.00
Kidder	188	28,643.79	8	26,665.79	88.00	188.00
LaMoure	9	1,435.72	42	817.72	245.00	75.00
Logan	66	9,404.92	28	8,036.42	277.40	125.60
McHenry	146	22,720.56	14	20,949.46	197.10	106.00
McIntosh	46	6,209.87	32	5,422.87	25.00	123.00
McKenzie	419	64,714.78	1	56,627.93	0.00	0.00
McLean	159	21,042.50	15	19,597.60	606.40	0.00
Mercer	111	15,129.38	21	14,140.93	309.00	73.00
Morton	128	18,113.89	17	16,912.00	332.30	198.00
Mountrail	234	32,445.36	4	30,474.32	556.20	113.70
Nelson	30	2,694.45	37	1,487.70	490.70	163.40
Oliver	54	7,588.41	30	7,269.68	111.50	0.00
Pierce	102	13,660.93	22	11,288.45	610.18	335.00
Ramsey	23	2,056.50	39	354.00	667.40	48.00
Ransom	7	1,120.00	45	785.00	135.00	0.00
Renville	12	1,910.12	40	1,873.22	25.00	0.00
Richland	4	513.68	47	360.68	30.00	0.00
Rolette	50	6,226.08	31	5,987.57	0.00	0.00
Sargent	8	1,127.79	44	757.79	166.00	20.00
Sheridan	183	25,826.44	10	23,091.52	1,036.80	358.00
Sioux	159	23,411.56	13	22,704.36	0.00	120.00
Slope	155	23,605.98	12	21,352.51	0.00	35.00
Stark	42	6,142.64	33	6,013.53	0.00	48.00
Towner	76	8,076.00	29	5,159.83	1,358.51	245.60
Walsh	3	201.02	48	193.02	0.00	0.00
Ward	73	11,038.98	25	10,449.70	0.00	80.00
Wells	43	5,248.80	33	4,587.46	153.00	77.20
Williams	250	38,399.32	2	37,588.27	65.00	0.00
Total	4,917	707,402.67		637,049.76	14,865.40	5,067.51

In 1990 the fair market value method of determining the opening bid for leased land was adopted. The fair market value is determined based on cash rents for grassland in the region and adjusted for differences between school land and private land. Using United States Department of Agriculture statistics, the lowest average county rent in the region is averaged over the last five years and reduced by 10 percent to find the rental value. Deducted from the rental value of private property is \$1.50 per acre for fencing and one-half the cost of leafy spurge control. The other half of spurge control may be recovered as a cost-share. The Land Department has paid 100 percent of the cost of controlling saltcedar, yellow star thistle, knapweed, and Canada thistle. The land

is adjusted for potential forage productivity. Using United States Department of Agriculture rental value survey statistics for 2007 and lease amounts for 2008, if the high rental value statistics are used, the approximate average reduction is approximately 44 percent. This reduced value is the minimum opening bid.

The lease prohibits a number of activities by the lessee without consent. The lessee may not:

1. Assign the lease.
2. Cultivate additional land.
3. Use the land for storage or dumping.
4. Make permanent improvements or major repairs. This does not include fences or water tanks. Permanent improvements and major

repairs may be depreciated or used as a rent credit with approval.

5. Prohibit public access.

The lessee is required to:

1. Control weeds, avoid erosion, and not overgraze.
2. Mow ditches.
3. Allow mineral exploration.

The income on surface leases was \$6,287,748 in fiscal year 2009. The appreciation on the property was \$2,096,568. The expenses for the surface management division were \$616,849. These expenses include payments to counties for roads and bridges in lieu of property taxes under NDCC Section 15-04-23. In addition, these expenses include land expenses under Section 15-04-24. These land expenses include appraisal fees; survey costs; surface lease refunds; weed and insect control costs; clean-up costs; capital improvement rent credits; rural fire district reimbursements for fire protection; land rental or land value survey costs; and other costs to manage, preserve, and enhance the property. In comparison to total expenses, the costs for lease auctions are relatively minimal. Lease auctions are held four out of five years. The lease auction process is electronically automated. The advertisements are generated electronically. The expiring leases are sorted electronically. The lease auctions are conducted by one person with a laptop computer. The results of the auction are uploaded electronically and the leases printed from the electronic files. The actual costs include:

1. Approximately 3,000 miles on a state vehicle.
2. Fourteen days for one person to conduct the auctions with meal and lodging expenses.
3. One day for one person to issue the leases.
4. Approximately \$400 postage to mail leases.
5. Advertising for approximately 40 auctions at approximately \$150 per auction.

North Dakota Century Code Chapter 15-05 governs the leasing of grant lands for coal; oil; gas; and other mineral rights, such as gravel, scoria, sand, and construction aggregate. The five-year limit for leases under Article IX, Section 8, of the Constitution of North Dakota, also applies to mineral interest leases on original grant lands. Section 15-05-10 provides that oil, gas, coal, and other mineral leases may be made by the Board of University and School Lands in such annual payments as are determined by the board and the section allows the board to adopt rules regarding annual payments and royalties. The Board of University and School Lands has adopted rules governing mineral leasing for lands under the board's jurisdiction. The board is not an administrative agency under Chapter 28-32, so its rules are not published in the North Dakota Administrative Code, but the rules may be accessed on the board's website. The rules set out the standards the board applies to govern mineral leasing, including rules for notice and public auction, terms of

leases, bid acceptance and rejection, royalties, reports, audits, and other subjects.

## PREVIOUS STUDY

During the 2005-06 interim the Budget Committee on Government Services was directed to study state-owned real estate under 2005 House Concurrent Resolution No. 3305. The committee received information identifying state-owned real estate and studied the utilization of real estate owned by state agencies and institutions, the best use of state-owned real estate, and whether the state should establish and maintain an inventory of state-owned real estate. A survey was sent to state agencies requesting them to provide the following information to the committee regarding any state-owned real estate and vacant buildings:

- Restrictions on the use of the property.
- Restrictions on the use of proceeds from the sale of the property.
- Mineral rights.
- Easements.
- Leases and lease income.

From the results of the survey of 38 state agencies and institutions that own land and buildings, the committee learned total state-owned land as reported by state agencies and institutions totals 1,057,333 acres with an estimated value of \$405.6 million. The 1.1 million acres of state land comprise 2.4 percent of all land in North Dakota compared to federally owned land that totals 1.9 million acres, or 4.2 percent of all land in the state. Agencies and institutions own 1,820 buildings totaling 21.8 million square feet with a total estimated value of \$1.675 billion. Agencies reported total debt on these buildings of \$207.5 million.

The committee learned the Land Department is reviewing small tracts of land that it owns as part of state trust fund lands and that, upon approval of the Board of University and School Lands, the land may be sold and any proceeds would be deposited into the trust fund that owns the land. The Land Department reported the state has sold 1.8 million acres of the 2.5 million acres originally granted to the state, leaving 700,000 acres. The Land Department provides 5 percent of any income earned on state lands to the county in which the land is located.

The committee received information relating to the sale of real property of the state. The committee learned the Department of Corrections and Rehabilitation is authorized under NDCC Section 54-23.3-04 to sell land without legislative approval. The proceeds from the sale are to be deposited into the State Penitentiary land fund. The usual practice for the sale of state land is that it is authorized by a specific bill passed by the Legislative Assembly. The common practice to initiate a sale would be to obtain a current appraisal and prepare a bill authorizing the land sale.

The committee considered a bill draft that would have required the Office of Management and Budget

to maintain an inventory of state-owned assets. The Office of Management and Budget reported it maintains an inventory of state-owned land and a bill draft was not necessary to accomplish the inventory.

### **SUGGESTED APPROACH**

The three main concerns to be addressed by this study are the term of the leases, the sale of land, and giving a preference to present lessees. Two of the areas of study--the term of the lease and giving a preference--are controlled by North Dakota constitutional provisions. Because a change in the Constitution of North Dakota would require a vote of the people, the committee may wish to receive

testimony to see if there is popular support for the changes. The sale of land is as well governed by the constitution; however, Article IX, Section 5, of the Constitution of North Dakota, states "[t]he legislative assembly shall provide for the sale of all school lands subject to the provisions of this article." The committee may desire to receive testimony on the value of state land as a state asset as opposed to the cash from the sale of the state land and from agricultural producers of instances in which the policy of generally not selling does not appear to be the best use of the resource.

ATTACH:1