

State Of North Dakota

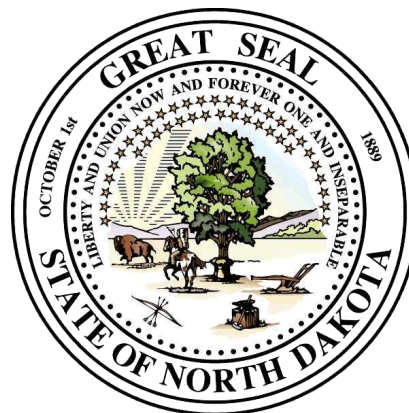


60th Biennial Report

of the

Board of University and School Lands
and Commissioner of University and School Lands

July 1, 2011 to June 30, 2013



December 2, 2013

The Honorable Jack Dalrymple
Governor of North Dakota
State Capitol
Bismarck ND 58505

The Honorable Alvin A. Jaeger
Secretary of State
State Capitol
Bismarck ND 58505

Dear Governor Dalrymple and Secretary Jaeger:

It is my privilege to present the 2011-2013 Biennial Report for the Board of University and School Lands and the Office of the Commissioner of University and School Lands. This report presents an overview of the Board and Commissioner's authority under the state constitution and laws, to manage permanent trusts for the benefit of education and certain state institutions.

In 2011 the Land Board adopted the Department of Trust Lands as the common reference to the agency. The statutory name remains the *Office of the Commissioner of University and School Lands*; however, the new name was chosen to recognize the Board and Department's important trust management responsibilities.

This document summarizes activities of the Commissioner and the Department to manage the permanent trusts, operate the state's Unclaimed Property Division, run the Energy Infrastructure and Impact Office, as well as oversee several statutory funds on behalf of the Land Board.

I am pleased to report that all trust balances and funds overseen by the Land Board remain healthy and continue to grow, many at a remarkable pace. The combination of market based rents paid by farmers and ranchers, consistent investment returns, and robust oil and gas production of trust minerals resulted in the value of the Common Schools and other permanent trusts nearly tripling in size in four years, collectively growing from \$900 million to \$2.6 billion since 2009.

Permanent trust distributions are based on the average value of the trusts' financial assets, thus allocations to beneficiaries have increased. Collectively, the trusts disbursed \$98.5 million during 2011-2013, nearly 20 percent more than the previous biennium. Because of the growth of the balances, the amounts approved for distribution by the 2013 Legislature will grow 41 percent to \$138.7 million during the 2013-2015 biennium.

With the strong agricultural economy, the trusts continued to benefit from the partnership with ranchers and farmers whose stewardship of the land supports the Board and Department's role to safeguard its value today and for future generations. The Department works with producers to protect and enhance the quality of the land through prudent grazing management and control of weeds.

The dramatic expansion of North Dakota's energy economy has led to active leasing and production of the trusts' mineral interests. Royalty income to the trusts continued to grow as oil and gas leases were produced in the Bakken and Three Forks region. During the biennium, mineral related revenue increased the trusts' permanent value by nearly \$629 million. This money is invested to provide income and trust growth that will benefit education long into the future.

Strong investment gains and the Board's conservative investment approach enabled trust growth resulting in continued healthy distributions to beneficiaries. While low interest rates hampered the ability of the investment portfolio to generate strong fixed income returns, equity growth and income combined to contribute to the trusts' gains, allowing for a 2.42 percent return in FY2012 and 10.65 percent in FY2103.

This report includes initiatives and successes undertaken by the current Land Board and staff and their predecessors. Superintendent of Public Instruction Dr. Wayne Sanstead, who served on the Land Board since 1985, retired in 2012.

Special acknowledgment and appreciation is also extended to the employees of the Department of Trust Lands, for their dedication in serving the trust beneficiaries and the people of North Dakota. Rapid changes and dramatic growth have created challenges, but the educational community continues to be well-served by these committed and talented professionals.

With stable investment returns, expanding income sources, and prudent maintenance of real property, the trust beneficiaries have, and will, continue to benefit from the work of the Land Board and the Department of Trust Lands.

Respectfully submitted,

Lance D. Gaebe
Commissioner

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Policy of Non-Discrimination on the Basis of Disability

The Department of Trust Lands does not discriminate on the basis of disability in the admission or access to, or treatment or employment in, its programs or activities. A coordinator has been designated to ensure compliance with the non-discrimination requirements contained in §35.107 of the Department of Justice regulations. Please call (701) 328-2800 for information concerning the provisions of the Americans with Disabilities Act, and the rights provided thereunder as they relate to the agency and access to its records.

COMMISSIONER'S REPORT

Historical Overview

Board of University & School Lands

On February 22, 1889, Congress passed "An act to provide for the division of Dakota Territory into two states, and to enable the people of North Dakota, South Dakota, Montana and Washington to form constitutions and state governments . . ." This Act is commonly known as the Enabling Act. Section 10 of this act granted sections 16 and 36 in every township to the new states "for the support of common schools." In cases where portions of sections 16 and 36 had been sold prior to statehood, indemnity or "in-lieu" selections were allowed. In North Dakota, this grant of land totaled more than 2.5 million acres.

Under sections 12, 14, 16 and 17 of the Enabling Act (and other acts referred to therein), Congress provided further land grants to the state of North Dakota for the support of colleges, universities, the state capitol and other public institutions. These additional grants totaled approximately 668,000 acres, bringing the grand total of Enabling Act land grants to nearly 3.2 million acres.

Constitutional Authority

North Dakota's Constitution (Article IX), adopted on October 1, 1889, entrusted the management of these lands (both acquired land and grant land) to the "board of university and school lands" (the Land Board). The Land Board was initially made up of the governor as chairperson, the secretary of state as vice-chair, the attorney general, superintendent of public instruction, and the state auditor. On June 10, 1986, a constitutional amendment replaced the state auditor with the state treasurer.

Commissioner of University & School Lands

Under N.D.C.C. § 15-02-01, the Board of University and School Lands is required to appoint a commissioner to act on its behalf. Specific responsibilities of the Board and the Commissioner of University and School Lands (Commissioner) are set out in N.D.C.C. ch. 15-01 through ch. 15-08.1.

The Commissioner is responsible for the following:

- ◆ Acting as the general agent for the Board,
- ◆ Supervising all aspects and activities of the Department of Trust Lands,
- ◆ Having general charge and supervision of all grant lands and associated records, maps, books and papers, and
- ◆ Enforcing the Unclaimed Property Act.

In 2011, the Land Board appointed the Commissioner to also serve as the director of the Energy Infrastructure and Impact Office.

The Office of the Commissioner had informally been called the *State Land Department*; however, in 2011 the Land Board adopted the *Department of Trust Lands* as the common reference to the Office of the Commissioner.

Land Sales & Acquisitions

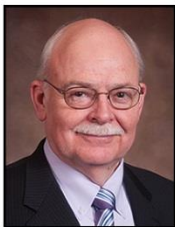
Since statehood in 1889, much of the grant land has been sold. Beginning in 1939, whenever the state sold grant land, it reserved 5 percent of the minerals. In 1941, the reservation was increased to 50 percent, and, since June 28, 1960, the North Dakota Constitution has mandated a 100 percent mineral reservation. Today, the Land Department manages in excess of 656,700 of the original, grant land surface acres, and more than 1.8 million of the original mineral acres. Approximately 50,700 acres have since been acquired through foreclosure or other means, bringing the total surface acreage to approximately 706,721 acres.

In 1977, the legislature transferred management authority for minerals acquired by the Bank of North Dakota and State Treasurer and responsibility for the minerals under sovereign land (navigable rivers/lakes) to the Land Board's oversight. On behalf of the Board, the Department manages 2.6 million total mineral acres.

The Land Board's members at the end of the 2011-2013 biennium:



Governor Jack Dalrymple
Chairman



Alvin A. Jaeger
Secretary of State
Vice Chairman



Wayne Stenehjem
Attorney General



Kirsten Baesler
Supt. of Public Instruction



Kelly Schmidt
State Treasurer

Superintendent Wayne Sanstead was a member of the Board until his retirement in 2012.

COMMISSIONER'S REPORT



Agency Overview

Lance Gaebe, Commissioner

The primary responsibility of the Department of Trust Lands is to manage the permanent educational trust funds and assets under the control of the Board of University and School Lands, as outlined in the North Dakota Constitution. State law also gives the Department the responsibility for managing the state Unclaimed Property Division and the state Energy Infrastructure and Impact Office, as well as overseeing sovereign mineral acres and several statutory funds.

Permanent Trust Funds

The land grant from the federal government at statehood and the state constitution both provide that the Board of University and School Lands manage the trust land and minerals and associated proceeds, for the exclusive benefit of education and institutional support. In accordance with Article IX of the North Dakota Constitution, the trust funds must be managed to preserve purchasing power and to maintain stable distributions to trust beneficiaries. Distributions from the trust funds are determined using the average value of trust assets over a five-year period.

Revenues are generated through the prudent management of permanent trust assets, consisting of 696,812 surface acres, 1.8 million mineral acres, and \$2.6 billion of financial assets. The surface acres are leased to ranchers and farmers, who assist in their care; mineral acres are offered for oil, gas, coal, gravel and scoria leasing. All revenues generated are deposited into the trust funds and are invested in a diversified portfolio of financial assets. Distributions are made to schools (public grades K-12) and other public institutions throughout the biennium.

The following institutions are the beneficiaries of the various permanent trust funds administered by the Department of Trust Lands pursuant to Article IX of the North Dakota Constitution:

- ◆ North Dakota State University
- ◆ University of North Dakota
- ◆ Mayville State University
- ◆ ND Youth Correctional Center
- ◆ Ellendale State College*
- ◆ Valley City State University
- ◆ State College of Science
- ◆ Common Schools
- ◆ School for the Blind
- ◆ School for the Deaf
- ◆ State Hospital
- ◆ School of Mines (UND)
- ◆ Veterans Home

**The beneficiaries of this trust are now Dickinson State University, Minot State University, Dakota College at Bottineau, Veterans Home, School for the Blind, State Hospital, and the State College of Science.*

The Common Schools Trust Fund is the largest of the permanent trusts administered by the Board. Total distributions to K-12 education for the 2011-2013 biennium were \$92,514,000, which equaled

approximately \$462 per year for each K-12 grade student in the state. Distributions from the Common Schools Trust Fund are paid out to the state's school districts by the Department of Public Instruction monthly from August to April of each year. The other 12 permanent trusts distributed a total of \$5.9 million during the biennium to their respective institutions.

In addition to the revenues from the surface lands, minerals and investments that the permanent trusts own, the Common Schools Trust Fund also receives 10 percent of the oil and gas extraction tax collected by the state (ND Constitution Article X, Section 24) and 45 percent of the proceeds from the tobacco class-action lawsuit settlement (N.D.C.C. § 54-27-25). It also holds the net unclaimed property proceeds collected by the department (N.D.C.C. § 15-10-05.2) until such time that property may be reunited with its owner.

Other Trusts and Funds

The Board manages a number of other funds either for the State of North Dakota or other beneficiaries:

Capitol Building Trust Fund

The Capitol Building Trust Fund was created under Article IX of the North Dakota Constitution for the construction and maintenance of "public buildings at the capital." This trust fund is not permanent in that the balance of the trust is subject to legislative appropriation each biennium.

Indian Cultural Education Trust

The Indian Cultural Education Trust was created in 2003 for the purpose of generating income to benefit Indian culture (N.D.C.C. ch. 15-68). The trust is managed for the benefit of the Mandan, Hidatsa & Arikara Nation Cultural Education Foundation. Available distributions from this trust are determined in the same manner as for the Common Schools Trust Fund.

Strategic Investment and Improvements Fund

The Strategic Investment and Improvements Fund (SIIF), which was created in 2011, holds the assets and collects the revenues earned from 758,000 sovereign mineral acres, including those formerly owned by the Bank of North Dakota and State Treasurer and minerals located under navigable rivers and lakes (N.D.C.C. ch. 15-08.1

(continued)

COMMISSIONER'S REPORT

(Agency Overview, continued)

and § 61-33-07). The SIF also receives a substantial portion of the oil and gas production and extraction taxes collected by the State (N.D.C.C. § 57-51.1-07.5). The balance of this fund may be expended by the legislature for one-time expenditures relating to improving state infrastructure or for initiatives to improve the efficiency and effectiveness of state government.

Coal Development Trust Fund

The Coal Development Trust Fund is a permanent trust established by N.D.C.C. § 57-62-02 pursuant to Section 21 of Article X of the North Dakota Constitution. The Fund receives 30 percent of the coal severance tax. This fund is held in trust and administered by the Board for loans to coal-impacted counties, cities, and school districts as provided by section N.D.C.C. § 57-62-03, and for loans to school districts pursuant to N.D.C.C. ch. 15.1-36. Any balance not loaned is invested according to the policies of the Board. The income earned by this trust is subject to legislative appropriation each biennium.

The agency also manages two other programs:

Unclaimed Property

The Department administers the Uniform Unclaimed Property Act (N.D.C.C. ch. 47-30-1.) Under this authority, the Department collects "unclaimed property" (uncashed checks, dormant bank accounts, lost securities, safe deposit boxes, unclaimed insurance proceeds, etc.), and attempts to reunite owners with that property. Property acquired under this Act is held in trust in perpetuity on behalf of the owner, allowing owners a place to search for their property. The investment earnings from unclaimed property become part of the Common Schools Trust Fund.

Energy Infrastructure and Impact Office

The Energy Infrastructure and Impact Office (EIIO) provides financial assistance to local units of government which are experiencing the impacts of energy activity (N.D.C.C. ch. 57-62). The office receives grant applications from cities, schools, counties, and other political subdivisions and makes award recommendations to the Land Board. As part of the review process, grant requests are reviewed by staff and an advisory board of local officials. The EIIO also administers the payout of funds to grant recipients as projects are completed.

COMMISSIONER'S REPORT

Funding Sources and Expenses

- ◆ Funding for the Department of Trust Lands operations is provided through the State Lands Maintenance fund. This fund consists of fees charged for services, plus a portion of the trust assets held by the various trusts (N.D.C.C. § 15-03-01.1).
- ◆ Energy impact grants are made from the Oil and Gas Impact Grant Fund. The administration expenses of the Energy Infrastructure and Impact Office are paid from the Oil and Gas Impact Grant Fund.

Board of University and School Lands

Statement of Appropriations - 2011-2013 Biennium

	Original Appropriation	Final Adjusted Appropriation	First Year 2012 Expenditures	Second Year 2013 Expenditures	Unexpended Appropriation on 6/30/13
State Lands Maintenance Fund:					
Salaries and Wages	\$4,145,824	\$4,296,546	\$1,805,190	\$2,068,228	\$423,128
Operating Expenses	1,431,096	1,431,096	418,151	365,653	647,292
Capital Assets	10,000	50,000	-	39,095	10,905
Contingencies	100,000	60,000	-	-	60,000
Total	\$5,686,920	\$5,837,642	\$2,223,341	\$2,472,975	\$1,141,326
Energy Infrastructure and Impact Office:					
Energy Grants	\$99,778,269	\$134,645,269	\$10,008,830	\$56,492,854	\$68,143,585
Flood Infrastructure Development Grants	\$0	\$30,000,000	\$28,633	\$3,816,604	26,154,763
Total	\$99,778,269	\$164,645,269	\$10,037,463	\$60,309,458	\$94,298,348
Strategic Investment and Improvements Fund:					
North Dakota General Fund	\$305,000,000	\$305,000,000	\$0	\$305,000,000	\$0

Operations

Operating expenses have and will continue to increase to accommodate the growth in the energy sector, which has impacted all responsibility areas within the Department of Trust Lands. The department has 25 permanent staff, two part-time employees and 10 part-time field staff. The 63rd Legislative Assembly approved an additional six positions for the Department in 2013.

The workload of staff has expanded due to added responsibilities and accelerated and expanded activity in all divisions. Tract inspections, easement and surface use requests, lease activity, reclamation efforts and title work have all increased with the expanded energy

activity. Similarly, the number of producing properties under management, the quantity and magnitude of damage, bonus and royalty transactions, and the size of the funds under management have all increased markedly. The dedicated staff directly manages the surface, mineral and financial assets of trusts utilizing effective accounting and computer tools that assist in the tracking of the revenues and assets of 18 funds, hundreds of requests for information and grant requests, thousands of transactions, tens of thousands of unclaimed property owners, millions of acres, and billions of dollars of trust assets.

COMMISSIONER'S REPORT

Other Department of Trust Land Department Information

Publications

In addition to this report, the Department publishes:

- ◆ Lists of tracts to be leased at quarterly oil and gas lease sales, together with a summary of the results of these sales;
- ◆ A semi-annual newsletter which is distributed to surface lessees and other interested parties;
- ◆ Lists of individuals entitled to unclaimed property (N.D.C.C. § 47-30.1-19.1);
- ◆ Summaries of grant awards made by the Energy Infrastructure and Impact Office;
- ◆ An informational brochure relating to owners of unclaimed property;
- ◆ An informational brochure relating to holders of unclaimed property; and
- ◆ An informational brochure relating to the operations of the Department of Trust Lands.

Notice of the leasing and sale of surface and mineral tracts is given by publication in the official county newspaper where the property is located. Newly reported unclaimed property owners are published in the official county newspaper of the owner's last known address.

Meetings

The Board of University and School Lands meets monthly. The regular meeting day is the last Thursday of the month.

Minutes of the Board and other information regarding the activities of the Department of Trust Lands can be obtained from:

Department of Trust Lands
1707 N 9th Street
P.O. Box 5523
Bismarck, ND 58506-5523

General Information: 701-328-2800
Fax: 701-328-3650

Internet Address

The Department of Trust Lands maintains a website at:

www.land.nd.gov

COMMISSIONER'S REPORT

Department Structure



INVESTMENTS DIVISION (Jeff Engleson)

Responsible for the prudent investment of \$3.5 billion in trust financial assets by allocating funds, monitoring performance, and reviewing money managers' compliance with Board policy.



SURFACE MANAGEMENT DIVISION (Mike Brand)

Responsible for oversight and active management of 707,000 acres of grazing and farm land, including leasing land for agriculture use and surface minerals, processing easement requests, and enhancing tract value.



MINERALS MANAGEMENT DIVISION (Drew Combs)

Responsible for managing 2.6 million acres of mineral interests by maintaining title and lease records, issuing leases, tracking production status of tracts, and promoting development.



UNCLAIMED PROPERTY DIVISION (Linda Fisher)

Responsible for administering the Uniform Unclaimed Property Act by collecting, documenting, and advertising unclaimed financial and tangible assets and providing owners with opportunities to claim.



ACCOUNTING/BUDGET DIVISION (Peggy Gudvangen)

Responsible for financial reporting, monitoring fund distributions, tracking operational expenses, preparing budget and payroll, assisting with procurement, and maintaining the general ledger.



REVENUE COMPLIANCE DIVISION (Pam Rennich)

Responsible for collecting and recording all royalty and revenue. Also responsible for compliance audits and maintaining proper internal controls.



INFORMATION TECHNOLOGY DIVISION (Levi Erdmann)

Responsible for oversight and maintenance of the Department's information systems, providing software development and database design, and managing the website, e-documents, and geospatial data.



ENERGY INFRASTRUCTURE AND IMPACT OFFICE (Gerry Fisher)

Responsible for administering the grant program that supports local units of government impacted by oil and gas development.

COMMISSIONER'S REPORT

Department Personnel

As of June 30, 2013



Back Row Left to Right:

Peggy Gudvangen, Cory Barth, Gerard Fisher, Levi Erdmann, Lance Gaebe, Jeff Engleson, Michael Brand, Jerry Saude

Middle Row Left to Right:

Loa Tober, Monica Glanville, Geraldine McGregor, Bonita Pazdernik, Bev Jacobson, Jayden Pascua, Michael Humann, Gustavo San Jose, Judith Schell

Seated Left to Right:

Melissa Seifert, Keith Bayley, Diane Nelson, Adam Otteson, Matthew Lengenfelder, Drew Combs, Linda Fisher, Michael Haupt

Not Pictured:

Pam Rennich and Deb Jacobs

EMPLOYEE	POSITION	SERVING SINCE:
Brand, Michael	Surface Management Director	1979
Engleson, Jeff	Deputy Commissioner and CFO	1986
Haupt, Michael	Land Management Professional	1987
Humann, Michael	Rangeland Professional	1987
Bayley, Keith	Land and Minerals Professional	1988
Fisher, Linda	Unclaimed Property Administrator and COO	1991
Saude, Jerry	Trust Land Specialist	1991
Pazdernik, Bonita	Office Assistant	1997
Jacobs, Debra	Administrative Assistant	1998
Tober, Loa	Administrative Assistant	1998
Pascua, Jayden	Computer Network Specialist	1999
Schell, Judith	Administrative Assistant	2000
Erdmann, Levi	Information Technology Director	2003
Glanville, Monica	Audit Technician	2003
Gudvangen, Peggy	Accounting Director	2005
Jacobson, Bev	Office Assistant	2006
Gaebe, Lance	Commissioner	2010
Combs, Drew	Minerals Management Director	2011
Nelson, Diane	Mineral Title Specialist	2011
Rennich, Pamela	Revenue Compliance Director	2011
Otteson, Adam	Revenue Compliance Auditor	2011
Fisher, Gerard	Energy Impact Office Administrator	2011
McGregor, Geraldine	Office Support	2012
Barth, Cory	Natural Resources Professional	2012
Seifert, Melissa	Account/Budget Specialist	2013
Lengenfelder, Matthew	Programmer/Analyst	2013

Also employed during the biennium: Laney Herauf, Legal Intern; Chad Fretheim, Energy Impact Assistant; Duane DeKrey, Flood Impact Grants Assistant; Michelle Erdmann, Energy Impact Engineer; Brian Backes, Accountant; and Andrew Weixel, Programmer

DIVISION REPORTS



Minerals Management

Drew Combs, Director

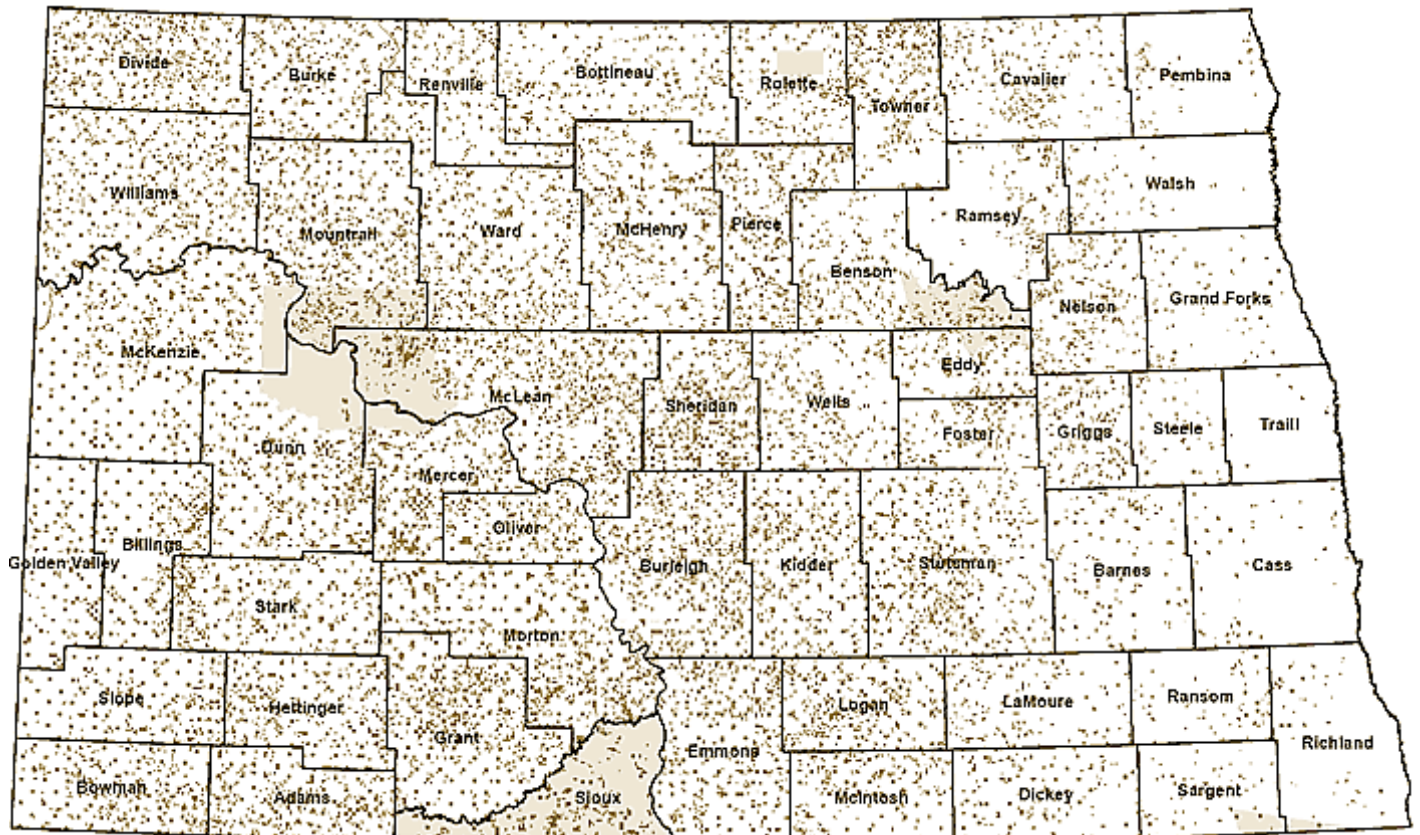
The Minerals Management Division administers the mineral acres held by the Common Schools Trust and the other institutional trusts. It also manages the state's mineral interests, including those formerly owned by the Bank of North Dakota and State Treasurer and the minerals that lie beneath navigable lakes and rivers.

Mineral acres are leased for the production of oil, gas, coal and other minerals. The Division ensures and documents the ownership integrity of the mineral assets, manages leasing and assignments, and tracks drilling and mining activity to ensure the Board's rules and terms of the lease are followed.

The Minerals Management Division responsibilities include:

- ◆ Title work (proving title, managing record of title, researching, etc.);
- ◆ Reviewing pooling agreements, lease assignments, lease extensions;
- ◆ Conducting quarterly mineral lease auctions;
- ◆ Public reporting and outreach;
- ◆ Reviewing requests for seismic permits;
- ◆ Monitoring Industrial Commission and other mineral regulatory action;
- ◆ Determining sovereign mineral acres;
- ◆ Promoting North Dakota's lesser-known minerals, including potash and uranium;
- ◆ Negotiating leases for coal development within the largest deposit of lignite in the world;
- ◆ Working with the surface management division on surface mineral mining and salt water disposal wells; and
- ◆ Working with the Revenue Compliance Division to ensure proper payment of royalties.

Distribution of Trust Minerals



(continued)

DIVISION REPORTS

(Minerals Management, continued)

With responsibility for 2.6 million mineral acres, the Department oversees one of the largest blocks of mineral assets within the Williston Basin. More than 800,000 acres are leased for oil and gas production:

Trust Name	Acres Leased for Oil and Gas Production
Common Schools	511,595.9
Ellendale State College	2,596.0
Mayville State University	2,233.2
NDSU	9,742.7
School for the Blind	2,232.4
School for the Deaf	4,101.4
State College of Science	2,489.9
State Hospital	2,608.9
State Industrial School	6,784.1
UND	7,143.4
Valley City State University	2,501.3
Veterans Home	1,048.7
Capitol Building	3,551.4
SIIF	242,898.2
	801,527.4

Coal Production

Coteau Properties Company, Falkirk Mining Company, BNI Coal, American Colloid Company, and Dakota Westmoreland Corporation all actively mine trust minerals. There are currently 47 coal production leases containing 4,098.86 net mineral acres.

The division leased 701.96 acres in Oliver and Mercer counties for coal mining in 2012. With the development by North American Coal Corporation of the Coyote Creek Mine in Mercer County, additional leasing and mining of trust coal is anticipated. Initial mine plans show a significant portion of that mine being leased from the trusts.

Potash

There are currently 3,906 acres under potash leases, but there are no active mining operations. The division continues to respond to inquiries into the potential for potash exploration and production. According to the North Dakota Geological Survey, potash beds occupy an area of 11,000 square miles that extends from the Montana border to central Bottineau County and from the Canadian border to central Dunn County. North Dakota's potash deposits have not been mined because they are deeper than those found in Saskatchewan.

Other Mineral Assets

The Department has responded to growing interest in commercial-grade diamond production, as well as potential uranium development. The interested parties are currently in the planning and feasibility phase.

Oil and Gas

Nearly one-third of the wells in North Dakota have some part of their unit containing a mineral asset managed by the Department. While nearing the end of major leasing activity in the highly productive areas, the division is seeing an increase in maintenance and curative title work. Now that the "rush" for competitive areas is tapering, companies are taking a closer look at their leased assets and clarifying real or perceived title defects. As many of the state's mineral acres were acquired through foreclosures during the first half of the state's history, records are often sketchy or conflicting. Title defects that involve complicated legal issues of railroad and road easements, statutes, and laws involve lengthy and complicated research.

The delineation of ownership of the state minerals beneath the navigable Missouri and Yellowstone Rivers remains contentious. The question of ownership of the minerals up to the ordinary high watermark is in litigation. The North Dakota Supreme Court is considering the issue.

Divisions of leases to multiple parties are becoming more complex and complicated. During this biennium, 5,238 leases were assigned.

(continued)

DIVISION REPORTS

(Minerals Management, continued)

Oil and Gas Lease Bonus Statistics by County									
County	2007-2009			2009-2011			2011-2013		
	Acres	Bonus	Avg Bonus per Acre	Acres	Bonus	Avg Bonus per Acre	Acres	Bonus	Avg Bonus per Acre
Adams				28,811.73	396,871.74	13.77			
Billings	6,321.43	1,129,598.05	178.69	17,774.82	22,679,062.35	1,275.91	9,517.39	11,231,739.18	1,180.13
Bottineau	6,288.37	360,670.40	57.36	11,208.98	532,904.53	47.54	2,250.82	24,844.62	11.04
Bowman	1,280.68	28,113.10	21.95	1,540.25	84,052.50	54.57	4,297.42	454,711.35	105.81
Burke	471.48	105,988.35	224.80	31,539.17	20,885,394.55	662.20	6,357.33	2,347,586.35	369.27
Burleigh				1,041.21	4,881.21	4.69			
Divide	4,352.90	958,392.88	220.17	38,487.74	30,396,695.90	789.78	18,004.04	27,496,372.05	1,527.23
Dunn	6,217.18	5,144,815.25	827.52	10,787.23	19,438,892.05	1,802.03	19,658.34	39,352,416.13	2,001.82
Emmons				1,749.39	13,195.97	7.54			
Golden Valley	23,361.72	1,423,236.52	60.92	12,293.11	5,274,122.40	429.03	5,196.22	1,156,921.50	222.65
Grant	200.00	400.00	2.00				15,844.01	17,762.77	1.12
Hettinger	1,120.00	10,480.00	9.36	2,413.02	682,600.45	282.88	11,677.97	2,660,384.83	227.81
McHenry	20.00	40.00	2.00	2,553.75	45,770.73	17.92			
McIntosh				1,702.66	41,787.62	24.54			
McKenzie	10,870.79	15,719,224.07	1,446.01	73,648.92	176,542,219.45	2,397.08	15,252.45	65,645,868.00	4,303.96
McLean	16,477.86	3,187,573.56	193.45	1,286.00	221,060.00	171.90	492.70	57,505.00	116.71
Mercer	23,284.29	2,689,992.10	115.53	740.00	3,460.00	4.68			
Morton	229.81	229.81	1.00						
Mountrail	2,276.32	2,690,109.40	1,181.78	24,986.22	67,490,785.20	2,701.12	9,482.43	9,595,061.15	1,011.88
Pierce	20.00	20.00	1.00						
Renville	9,664.55	1,128,872.67	116.81	4,982.53	396,516.20	79.58	1,336.93	40,093.40	29.99
Slope	7,505.49	89,937.72	11.98	4,655.10	434,166.40	93.27	20,339.09	3,961,670.08	194.78
Stark	23,617.37	591,682.98	25.05	10,286.49	9,000,033.43	874.94	5,021.26	5,836,650.40	1,162.39
Stutsman				394.32	3,234.56	8.20			
Ward	20,304.55	2,177,128.40	107.22	3,657.14	337,701.80	92.34	11,696.79	748,909.54	64.03
Wells	237.08	237.08	1.00	3,069.98	6,139.96	2.00			
Williams	9,681.25	2,260,905.88	233.53	42,924.02	117,598,584.75	2,739.69	6,762.99	22,117,419.00	3,270.36

Leased Oil and Gas Tracts by County and Status						
County	Primary		Total Leases	Primary Term Lease Acres	Held by	
	Term Leases	Held by Production Leases			Production Acres	Total Acres
Adams	356	-	356	28,811.7	-	28,811.7
Billings	233	275	508	21,860.9	30,324.5	52,185.4
Bottineau	227	41	268	12,738.9	4,350.9	17,089.7
Bowman	95	155	250	5,758.3	18,020.8	23,779.1
Burke	401	184	585	30,846.3	20,093.4	50,939.7
Burleigh	9	-	9	1,041.2	-	1,041.2
Divide	462	419	881	37,748.2	33,624.4	71,372.6
Dunn	290	558	848	19,747.3	50,832.3	70,579.5
Emmons	24	-	24	1,749.4	-	1,749.4
Golden Valley	305	24	329	17,489.4	3,616.0	21,105.4
Grant	125	-	125	13,684.0	-	13,684.0
Hettinger	171	-	171	14,171.0	-	14,171.0
McIntosh	31	-	31	2,553.8	213.6	2,767.3
McHenry	43	4	47	1,702.7	-	1,702.7
McKenzie	350	1,446	1,796	36,969.3	119,879.8	156,849.2
McLean	210	11	221	1,698.7	840.0	2,538.7
Mercer	32	2	34	740.0	158.7	898.7
Mountrail	308	875	1,183	16,099.6	67,566.8	83,666.4
Renville	124	26	150	7,278.5	2,707.5	9,985.9
Slope	415	3	418	24,952.9	160.0	25,112.9
Stark	308	144	452	23,587.1	12,048.1	35,635.2
Stutsman	5	-	5	394.3	-	394.3
Ward	363	5	368	20,732.2	253.1	20,985.3
Wells	39	-	39	3,070.0	-	3,070.0
Williams	209	838	1,047	17,709.4	73,702.8	91,412.2
	5,135	5,010	10,145	363,134.8	438,392.6	801,527.4

DIVISION REPORTS



Surface Management

Michael D. Brand, Ph.D., Director

This division leases and manages surface acres owned by the various trust funds under the control of the Board of University and School Lands. The major source of income from these lands comes from grazing and agricultural leases, with significant revenue generated from rights-of-way, salt water disposal, and gravel and scoria mining. The objective of surface management is to obtain a "fair market" return from the lands while maintaining or improving their condition and value.

Land Management

Much staff time is spent on day-to-day land management projects that are not remarkable individually but in aggregate result in significant improvement in school trust lands. These projects include:

- ◆ Grazing management plans for improving range condition and productivity;
- ◆ Developing dams and dugouts for livestock water and wildlife enhancement;
- ◆ Cooperative trash site clean-up and abandoned water wells sealing;
- ◆ Gravel and scoria mine site reclamation;
- ◆ Oil well pad, pipeline, and road siting and reclamation;
- ◆ Coal mine reclamation on trust lands; and
- ◆ Monitoring flood affected tracts.

Many of these projects are initiated and completed each biennium while some, such as grazing management plans, require 10-15 years or more to achieve lasting results.

Field Personnel

Part-time field personnel have been critical to successful management of trust lands. They provide a quick response time and have allowed the division to absorb increased workloads generated by the energy activity.



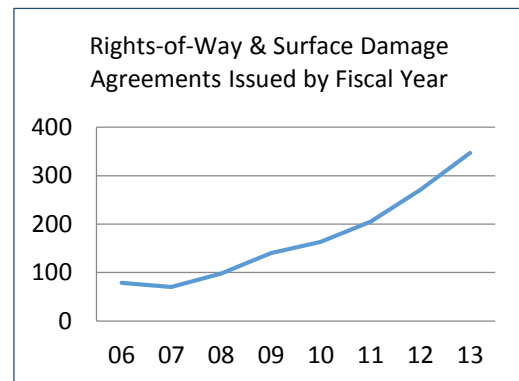
Top row left to right: Dale Ferebee, Roger Martin, Jim Alfonso, Frank Kartch, Larry Veikley. Bottom row left to right: Mike Sondeland, Lara Kitchen, Dennis Froemke, Karrie Froemke, Chris Hansen.

	Serving Since:
Larry Veikley, Minot	2002
Dale Ferebee, Beach	2005
Chris Hansen, Napoleon	1998
Mike Sondeland, Bowman	2008
Dennis Froemke, Dickinson	2011
Karrie Froemke, Dickinson	2012
Frank Kartch, Bismarck	2006
Roger Martin, Napoleon	1992
Jim Alfonso, Devils Lake	2012
Lara Kitchen, Tappen	2013

Rights-of-Way

Most rights-of-way are directly related to the impact of oil and gas development in the Bakken and Three Forks formations. There has been a steady increase in this area since 2006, and a plateau is not expected until sufficient pipelines and electrical lines have been installed to support the new wells in expanding fields. In 2013, new applications for well pads were mostly for multi-bore locations.

Rights-of-way produced approximately \$7.4 million in revenue during the 2011-2013 biennium, as compared to \$2.5 million the previous biennium. The increase is a combination of both higher-per-unit payments and a greater number of rights-of-way issued.



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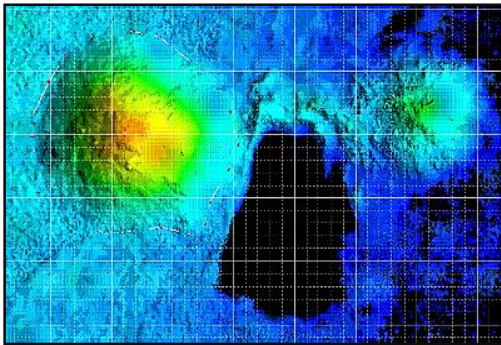
DIVISION REPORTS

(Surface Management, continued)

Reclamation and Gravel Mining

In 2012 a natural resource specialist position was added to the division specifically to manage reclamation on rights-of-way and gravel mines on trust lands. With 400 rights-of-way issued in 2012, reclamation oversight has become a major activity. Pipelines, roads and well pads require detailed input during the construction phase to ensure that the land is reclaimable. Topsoil reservation, erosion control, noxious weed control, and native grass seeding are essential to returning the land to a productive and ecologically stable condition.

With the increased demand for gravel in the oil fields, the price of construction aggregate, primarily gravel, has increased at least fourfold. As of June 30, 2013, there were 14 gravel leases on trust lands covering a total of 1,700 acres. Even though significant acres are disturbed each year by gravel mining in North Dakota, it is an unregulated industry. Because there is no governmental oversight, the potential for poor reclamation and loss of royalty is significant. On trust lands, reclamation oversight is the responsibility of the natural resource specialist. To track the amount of gravel mined, a new program using LIDAR (Light Detection and Ranging) was instituted in the spring of 2013. LIDAR uses laser light to survey pit volumes to sub-centimeter accuracy. More than 200 million geo-referenced points are periodically taken on each gravel mine to track volumes mined.



LIDAR image of gravel stockpile



LIDAR Equipment

Surface Acres by Trust Fund As of June 30, 2013

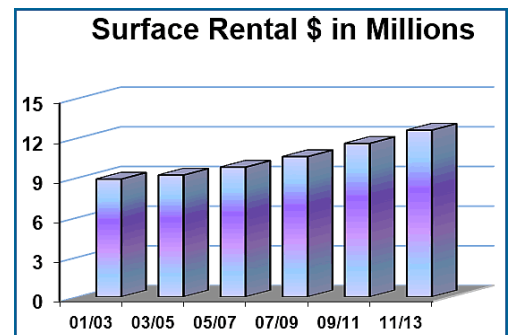
Trust Fund	Acres
Common Schools	631,778.83
School for the Blind	3,481.69
Capitol Building	9,994.45
School for the Deaf	4,830.44
Ellendale State College	4,912.82
State Hospital	2,206.11
ND Youth Correctional Center	3,744.42
School of Mines ¹	3,313.81
N.D.S.U.	15,117.68
Veterans Home	2,753.69
U.N.D.	8,897.98
Valley City State University	640.00
ND State College of Science	3,712.94
Mayville State University	640.00
Valley City/Mayville ²	6,821.85
Farm Loan Pool ³	3,714.00
Indian Cultural Education	160.00
Total	<u>706,720.71</u>

1. The benefits of the original grant to the School of Mines are distributed to the University of North Dakota.
2. Receipts from acreage held jointly by Valley City and Mayville State Universities are allocated 62.5% to Valley City and 37.5% to Mayville.
3. Receipts from this acreage are allocated to the permanent trusts that have an interest in the Board's Farm Loan Pool.

Leasing

A total of 2,444 grazing and agricultural leases were issued during the 2011-2013 biennium. Leasing interest continued to be high with a success rate of more than 99 percent. Flooded land has remained relatively constant with the previous biennium.

Total rental income for the biennium was \$12.6 million, an increase of 8.6 percent over the previous biennium.



(continued)

DIVISION REPORTS

(Surface Management, continued)

Private land rental rates are the basis for calculating the minimum opening bid on school trust lands. The rental market for grazing lands has remained strong with continued increases in private land rental rates. Normally there is at least one significant decline in rents during each 20-year period, but the private grassland rental market prices have been increasing for the past 25 years.

Continued high prices for crops have helped maintain a strong demand for cropland rental property. The high prices for small grains and row crops have contributed to conversion of grassland to cropland on private property. This is likely a factor in maintaining the strong rental market for grazing land.

For 30 years the *Land Line* newsletter provided information for surface lessees twice each year. The first issue was in the spring of 1983 and the last of 61

issues was in the spring of 2013. The *Land Line* was discontinued because most lessees now have access to the Internet, and detailed information is now provided on the Department's website.

Invasive Plants

Noxious weed control remains and will remain an important focus on trust lands. Leafy spurge, Canada thistle and houndstongue are the major weeds at this time and have the potential to increase exponentially if ignored. Salt cedar was not inventoried during this biennium so it is not known if it has increased. Russian knapweed, spotted knapweed and star thistle appear to be under control.

New potentially invasive weeds have not been reported this biennium and monitoring for them is ongoing.

The Department of Trust Lands continues to pay 100 percent of the cost of controlling salt cedar, yellow star thistle, knapweed, houndstongue and Canada thistle on trust lands. Tracts with leafy spurge receive a rent reduction when the lease is bid and a 50 percent cost share when the control work is completed. This commitment has been an important part of preventing the establishment and spread of these weeds.

Kentucky bluegrass has been increasing over at least the past decade and is moving into native grasslands in central and west central North Dakota. There has not been any indication that this trend has reversed and it poses a continued threat to the ecological integrity of the native prairies.

Land Sales and Acquisitions FY12-FY13	
Acquisitions:	Acres:
(+)Acreage Corrections	14.23
Railroad Abandonment	10.22
Right-of-Way Reversions	16.91
Farm Loan Pool Foreclosure	942.24
Total Acquisitions	983.60
Sales:	
Sales to public entities	150.00
Sales at public Auction	1,061.64
(-)Acreage Corrections	18.00
Total Sales	1,229.64

Surface Acres by County As of June 30, 2013					
County	Acres	County	Acres	County	Acres
Adams	17,097.52	Golden Valley	28,983.55	Ramsey	2,056.50
Barnes	2,803.32	Grant	33,495.92	Ransom	1,120.00
Benson	11,965.93	Griggs	1,741.24	Renville	1,910.12
Billings	30,927.06	Hettinger	9,889.95	Richland	513.68
Bottineau	3,271.94	Kidder	28,643.79	Rolette	6,226.08
Bowman	29,310.48	LaMoure	1,435.72	Sargent	1,128.17
Burke	16,137.16	Logan	9,404.92	Sheridan	25,826.44
Burleigh	27,890.13	McHenry	22,720.56	Sioux	23,411.56
Cass	40.00	McIntosh	6,209.87	Slope	23,605.98
Cavalier	556.47	McKenzie	64,624.78	Stark	6,150.13
Dickey	3,981.51	McLean	20,890.99	Stutsman	15,627.81
Divide	20,791.24	Mercer	15,129.38	Towner	8,076.00
Dunn	25,666.71	Morton	18,085.64	Walsh	160.00
Eddy	10,281.04	Mountrail	32,433.47	Ward	11,038.98
Emmons	13,533.97	Nelson	2,694.45	Wells	5,251.89
Foster	3,111.51	Oliver	7,588.41	Williams	38,343.04
Grand Forks	1,274.77	Pierce	13,660.93	Total	706,720.71

DIVISION REPORTS



Unclaimed Property

Linda Fisher, Administrator

The Unclaimed Property Division administers and enforces the Uniform Unclaimed Property Act (N.D.C.C. ch. 47-30.1). The purpose of the Act is to collect and safeguard property remitted by holders; to publish properties and provide owners with opportunities to claim; and to support the Common Schools Trust Fund with revenues earned on funds that remain unclaimed. The Act has been in effect since July 1, 1975.

Statutory Outreach Requirements

- ◆ County newspaper legal publication - names/last known address
- ◆ Advertisements in county newspapers

Additional Outreach Efforts

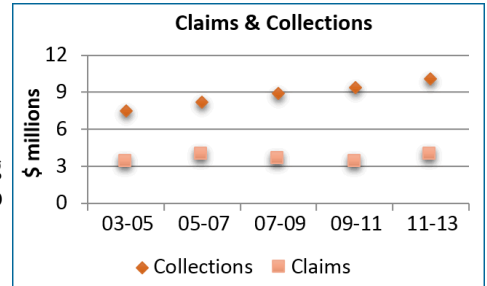
- ◆ Free searchable websites at land.nd.gov and missingmoney.com
- ◆ E-mail distribution to on-line user groups (State and County government, education system etc.)
- ◆ Television and radio interviews
- ◆ Service club presentations
- ◆ Address updates and direct mailings
- ◆ Cooperative Agreement for data matching with ND Child Support

The Internet continues to be the most effective outreach tool. During this biennium, the Division search page was modified to incorporate a claim “wizard” that allows searchers to receive customized instructions for filing a claim. As a result, claimants are not requested to provide any more documentation than what is needed, and claims processors are seeing an increase in the number of properly documented claims resulting in less follow-up with claimants. Self-service, web-generated claims accounted for 62 percent of the 10,000+ claims initiated in the biennium.

Compliance and Education

In recognition of the importance of compliance to the success of the program, the Division continues to rely on the services of external third-party contingency auditors to provide compliance and education services. Third-party auditors have been contracted to help with

compliance since 1984, and additional contingency auditors were procured during the biennium to strengthen that effort. As of June 30, 2013

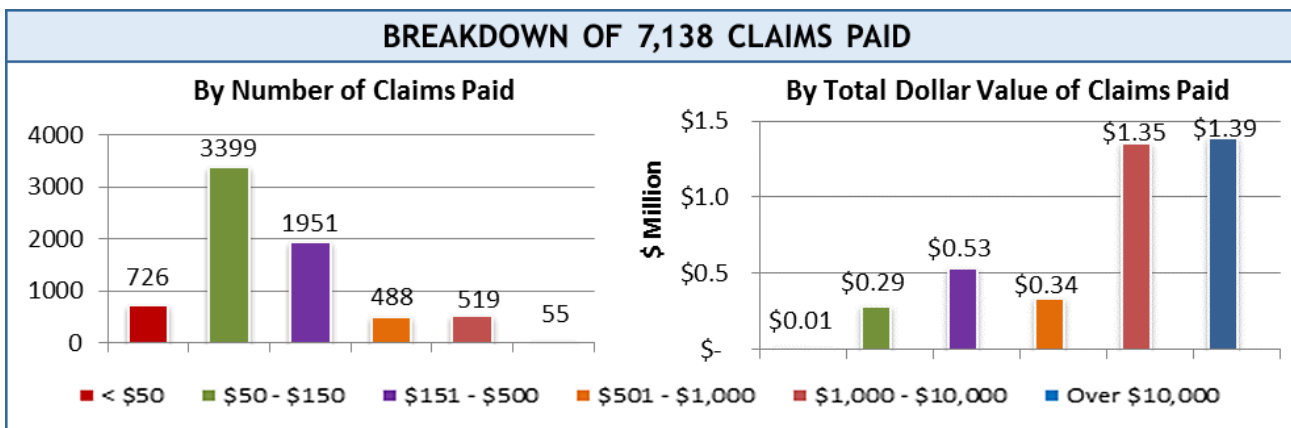


there were six active compliance contracts in place. In-house staff education efforts, limited mostly to direct mailings and some phone contact, have been focused on specifically identified industry groups with poor (or no) compliance history.

Legislation (63rd Legislative Assembly)

The Department introduced legislation, which passed in 2013, to lift the restriction of third-party audits with respect to North Dakota businesses (SB2058). A bill submitted by the ND Banker’s Association which clarified the definition of a money order for determining proper dormancy also passed (HB1162).

The most notable change to reporting requirements in this biennium came through a nationwide effort undertaken by unclaimed property offices and state insurance commissioners to require life insurance providers to utilize the death master index to identify deceased policy holders, to attempt contact with policy beneficiaries, and to remit residual unclaimed benefits to state unclaimed property programs. The 2013 legislature changed reporting requirements for insurance providers in HB1171.



DIVISION REPORTS



Investments

Jeff Engleson, Director

The Investment Division is responsible for directing, implementing, coordinating and monitoring the Land Board's investment program. As of June 30, 2013, the total value of investment assets managed by the Department totaled approximately \$3.48 billion. The majority of these assets (\$2.54 billion) are owned by 13 permanent educational trusts under the Board's control, and the remainder are assets of the Strategic Investment and Improvements Fund, the Coal Development, Capitol Building trust fund and Indian Cultural Education trust funds.

The type of investment assets owned by each trust fund managed by the Board is determined by the nature or purpose of the fund, investment goals and objectives of the fund, and the timing and amount of distributions from the fund.

The 13 educational trust funds managed by the Board are permanent in nature, and were established to provide funding for education in North Dakota, both today and for future generations. The Indian Cultural Education trust is similar in nature to the permanent trusts and is invested in an investment pool with those trusts. The long-range goal for all of these trusts is to have an investment program that will allow trust assets and distributions to beneficiaries to increase at a rate that meets or exceeds the historic annual rate of inflation. To that end, the Board has developed an investment allocation plan that includes a well-diversified portfolio of stocks, bonds and other financial assets.

The primary purpose of the Coal Development Trust Fund is to provide loans to political subdivisions, as directed by the Legislature. The Board is responsible for administering the trust and investing any monies that have not been lent. While loans to political subdivisions totaled \$40.14 million, the remaining \$24.81 million of this trust is invested in a relatively short-term, high-quality bond portfolio to ensure that funds are available to make loans when needed.

The expendable nature of both the Strategic Investment and Improvements Fund (SIIF) and Capitol Building Trust funds results in these trusts being invested in short-term, high-quality Treasury bonds, CDs and cash equivalents, which have minimal chance of principal loss.

The total value of investment securities and cash equivalents managed by the Board as of June 30, 2013, was \$3.48 billion. The following is a description of the types of assets held by the trusts and funds:

- ◆ **Marketable Securities:** As of the end of the biennium, \$2.54 billion of investment securities were held at a custodian bank, Northern Trust Company, and were managed by investment professionals hired by the Board to achieve specific investment goals and objectives. In addition, the

SIIF owned \$879.08 million of Treasury securities and cash equivalents that were held in custody at the Bank of North Dakota (BND) as of June 30, 2013. The Capitol Building Trust owned \$2.72 million of Treasury securities and cash equivalents that were also held in custody at the BND on that date.

- ◆ **Farm Loan Pool:** As of June 30, 2013, the total value of the Board's pool of farm real estate loans was \$19.12 million. The Investment Division works closely with the BND, which administers the individual loans, in developing and monitoring policies, goals and strategies for farm loans.
- ◆ **Other Loans:** As of the close of the biennium the Board had \$41.65 million of outstanding loans to political subdivisions and other entities. Coal Development Trust Fund loans included \$32.16 million in school construction loans and \$7.98 million in loans to coal impacted political subdivisions. Separately, through the Land Board's Energy Construction Loan Program, the Common Schools Trust owned \$1.51 million of loans for hotels, apartments and multi-family housing in western North Dakota.

Permanent Trust Assets and Distributions

The fund balance, or net assets, of the combined permanent trust funds increased by more than \$842.5 million during the biennium, from \$1.73 billion on June 30, 2011, to \$2.57 billion on June 30, 2013. Oil-related revenues (royalties, lease bonuses and oil extraction tax deposits) were responsible for more than \$628.75 million of trust growth during the biennium. The majority of the remaining growth was a result of investment income and capital gains earned by the portfolio during the biennium.

The permanent trusts' asset allocation remained at 51 percent equities and 49 percent fixed income during the biennium, although some manager changes were made within the portfolio. In 2012, J.P. Morgan was hired to manage an intermediate investment grade bond portfolio. With the large cash flows into the trusts, too many assets were being invested by one

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DIVISION REPORTS

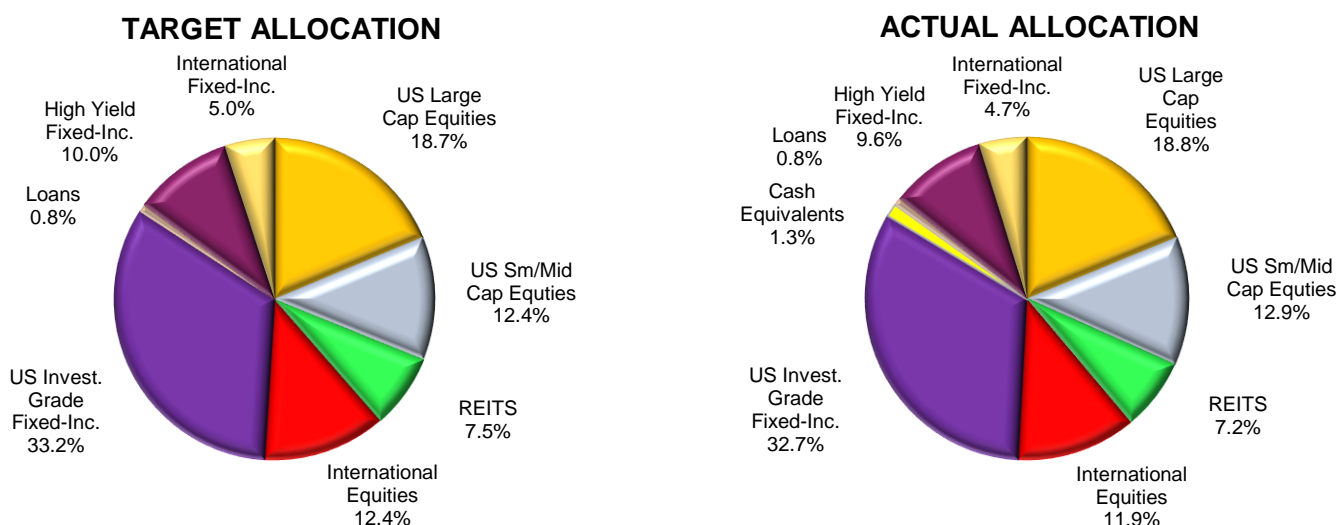
(Investments, continued)

manager (Payden & Rygel). The hiring of J.P. Morgan helped reduce manager risk in the portfolio. In addition, during the fall of 2012, the Board liquidated the convertible bond portfolio managed by Trust Company of the West (TCW) and reinvested the proceeds in existing equity mandates, keeping the total equity portion of the portfolio at 51 percent.

Distributions from the permanent trust funds are determined based on the amount of assets in the trust funds and the growth of those assets over a 5-year period. Prior to FY2009, distributions from the 13 permanent trust funds had been based on the amount of "interest and income" generated by each trust during a given year.

The distribution formula will have a major impact on how permanent trust assets will be managed in the future. The change will allow the Board to manage the portfolio more efficiently and effectively, while also balancing its dual responsibilities of preserving the purchasing power of the fund while maintaining stable distributions to trust beneficiaries. The portfolio is now managed in a way that provides for consistent, steady trust growth over time, rather than focusing on income.

The pie charts and table below show the permanent trusts' actual allocation and target allocation as of June 30, 2013.



Asset Class	Actual \$ million	Actual %	Target \$ million	Target %	Difference \$ million	% Diff.
US Large Cap Equities	\$ 477.97	18.8%	\$ 474.63	18.7%	\$ 3.34	0.1%
US Sm/Mid Cap Equities	326.51	12.9%	314.73	12.4%	11.78	0.5%
REITS	183.02	7.2%	190.35	7.5%	(7.33)	(0.3%)
International Equities	303.04	11.9%	314.73	12.4%	(11.69)	(0.5%)
Total Equities	\$ 1,290.54	50.8%	\$ 1,294.44	51.0%	(\$ 3.90)	(0.2%)
US Invest. Grade Fixed-Income	830.04	32.7%	842.33	33.2%	(12.29)	(0.5%)
Cash Equivalents	32.56	1.3%	0.00	0.0%	32.56	1.3%
Loans	20.63	0.8%	20.63	0.8%	0.0	0.0%
High Yield Fixed-Income	243.91	9.6%	253.81	10.0%	(9.90)	(0.4%)
International Fixed-Income	120.44	4.8%	126.91	5.0%	(6.47)	(0.2%)
Total Fixed-Income	\$ 1,247.58	49.2%	\$ 1,243.68	49.0%	\$ 3.90	0.2%
Total Portfolio	\$ 2,538.12	100.0%	\$ 2,538.12	100.0%		

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DIVISION REPORTS

(Investments, continued)

Portfolio Returns and Performance

The Department prepares quarterly reports that summarize both the performance of the total investment program and the performance of individual managers, and compares them to established benchmarks and goals.

The table below shows the amount allocated to the various permanent trust investment portfolios as of June 30, 2013. It shows the return earned by each portfolio over various periods and compares that return to a relevant benchmark.

MANAGER AND PORTFOLIO RETURNS						
<i>Returns for Periods ended June 30, 2013</i>						
Asset Class MANAGER Benchmark/Index	6/30/13 Allocation (\$ mil.)	% of Total Portfolio	Last 1 Year	Last 3 Years	Last 5 Years	Last 10 Years
Large Cap US Equity						
STATE STREET - S&P 500 Index	\$477.97	18.8%	20.55	18.43	7.01	-
S&P 500 Index			20.60	18.45	7.01	7.30
Small/Mid Cap US Equities						
NORTHERN TRUST	\$326.51	12.9%	25.25	18.15	-	-
STATE STREET - Small/Mid Index	\$127.28	5.0%	25.20	17.36	7.73	8.88
60% Russell 2000/40% Russell Mid Cap	\$199.23	7.9%	25.39	19.38	-	-
Russell Completeness Index			24.69	19.04	8.89	10.06
			25.36	19.23	8.57	10.20
Real Estate Investment Trusts (REITS)						
DELAWARE INVESTMENT ADVISORS	\$183.02	7.2%	7.91	18.14	7.62	-
NAREIT Equity REIT Index			9.40	18.18	7.57	10.88
TOTAL DOMESTIC EQUITIES	\$987.50	38.9%	19.51	16.29	-	-
International Equities						
STATE STREET - International Alpha	\$303.04	11.9%	22.11	9.12	-	-
NTGI - EAFE Index	\$247.64	9.7%	22.56	9.25	(1.99)	-
MSCI EAFE Index	\$55.40	2.2%	-	-	-	-
			18.62	10.04	(0.63)	7.67
TOTAL EQUITIES	\$1,290.54	50.8%	19.86	14.86	4.25	6.93
US Investment Grade Fixed Income						
PAYDEN & RYGEL - Aggregate	\$862.60	34.0%	(0.48)	3.95	-	-
JP MORGAN - Intermediate	\$261.30	10.3%	1.16	4.58	6.44	5.24
BND - Project Notes	\$264.15	10.4%	-	-	-	-
PAYDEN & RYGEL - GNMA/Short Bond	\$2.69	0.1%	1.52	3.69	5.27	5.01
NORTHERN TRUST - TIPS	\$134.69	5.3%	2.10	3.64	4.72	4.05
PAYDEN & RYGEL - Cash	\$167.21	6.6%	(4.75)	4.68	4.43	-
Barclay's Capital US Aggregate Index	\$32.56	1.3%	0.05	0.04	0.21	1.76
Barclay's Intermediate Govt./Corp.			(0.67)	3.52	5.20	4.52
Barclay's Capital TIPS			-	-	-	-
6 Month T-Bill			(4.77)	4.63	4.40	-
			0.15	0.16	0.48	1.82
Loans						
BND - Farm Loan Pool	\$20.63	0.8%	5.14	5.89	-	-
BND - Energy Construction Loans	\$19.12	0.7%	5.12	5.88	6.30	6.96
	\$1.51	0.1%	5.33	-	-	-
US High Yield Fixed Income						
LAZARD ASSET MANAGEMENT	\$243.91	9.6%	6.75	8.68	8.30	-
Merrill Lynch US High Yield Cash Pay Index			9.19	10.31	10.44	-
Merrill Lynch BB/B Index			8.52	10.10	9.45	-
TOTAL DOMESTIC FIXED INCOME	\$1,127.14	44.4%	1.26	5.09	-	-
International Invest. Grade Fixed Income						
FIRST INT'L ADVISORS	\$120.44	4.8%	2.80	3.71	5.87	-
Merrill Lynch Broad Global (Ex-US) Index - Hedged			3.43	3.52	4.90	-
TOTAL FIXED INCOME	\$1,247.58	49.2%	1.42	4.95	5.89	5.30
TOTAL PORTFOLIO	\$2,538.121	100.0%	10.65	10.17	5.72	6.49

All return figures for periods of 1 year or greater have been annualized. All returns are net of fees.

(continued)

DIVISION REPORTS

(Investments, continued)

The Board's conservative approach to trust investments continued to work well during the biennium. During FY2012, when equity markets were down, the portfolio's strong fixed income returns resulted in the overall portfolio posting a positive 2.42 percent total return. During FY2013, when fixed income returns were hindered by historic low interest rates, the equity portion of the portfolio yielded nearly a 20 percent return which resulted in an overall annual portfolio return of 10.65 percent.

Over longer periods of time the investment portfolio has also performed well, posting returns of 10.17 percent, 5.72 percent and 6.49 percent over the trailing 3-year, 5-year and 10-year periods ending June 30, 2013. Included in the 5-year and 10-year returns was a substantial equity bear market and the worst recession since the Great Depression.

Other Trust Investment Assets

Historic low interest rates have significantly impacted the returns earned by the Coal Development and Capitol Building Trust Funds and the SIIF. All of these portfolios are invested in relatively short-term fixed income portfolios that are focused on capital preservation. As interest rates have fallen and remained low over the past few years, the yield earned by these portfolios has fallen dramatically.

The Coal Development Trust Fund is invested in a fixed income strategy that focuses on 1-year to 3-year bonds. The slightly longer investment horizon allowed it to earn a return of 1.31 percent for the trailing year ended June 30, 2013, and 1.15 percent per year for the 3-year period there ended, while still maintaining liquidity to support loan demand.

As both the Capitol Building Trust Fund and SIIF are subject to legislative spending, both have short-term investment time horizons. Although these funds were earning nearly 0.5 percent at the beginning of the biennium, by the end of the biennium they were invested 100 percent in U.S Treasury securities earning yields in the 0.15 percent to 0.17 percent range.

The ability of all of these funds to generate income going forward will be severely limited until short-term interest rates rise from the current extremely low levels.

Investment Study

As the size of the investment assets under management increased, the Board recognized the need to secure outside counsel on how to best manage its growing and more complicated investment program. In April of 2013, the Land Board hired R.V. Kuhns and Associates to perform an investment study.

The purpose of the study was to provide the Board and staff advice on:

- ◆ Recommendations for updated investment policies and procedures to help ensure that the Board meets its long-term goals and objectives for the permanent trusts;
- ◆ A proposed asset allocation policy for the permanent trusts that recognizes the Board's risk tolerance and return expectations, coupled with the Board's legal responsibilities to support trust beneficiaries, maintain the assets in the funds and follow the prudent investor rule;
- ◆ A strategy to transition the permanent trusts to the recommended plan; and
- ◆ A recommendation for establishing specific goals, objectives and investment policies for the SIIF.

The investment study will help modernize the Board's investment program and should ensure that trust assets and distribution grow in a steady, sustainable way.

Summary

The Land Board's conservative approach to trust management has allowed the portfolio to weather downturns, while also participating in the strong returns that have occurred since the end of the most recent recession.

DIVISION REPORTS



Revenue Compliance

Pamela Rennich, Director

A dramatic increase in oil activity has resulted in dramatic growth of revenues received by the trusts in the prior five years. The trusts receive royalties from more than 2,800 producing wells adding, on average, 70 new wells each month, an increase of 537 percent from five years earlier, and the number of royalty records processed in a given month has increased 600 percent. Due to this dramatic increase, the Revenue Compliance Division was established within the Department at the end of FY2011 to ensure that royalty and other collections made on behalf of the trusts and other funds are complete and accurate.

The Revenue Compliance Division manages procedures to assure timely and accurate revenue accounting of oil, gas, coal and aggregate royalties; mineral-related

payments; surface rents; surface damage payments; unclaimed property payments; and other cash receipts pursuant to the terms of State lease contracts, leasing rules and regulations, and state statutes. The division performs compliance reviews of entities submitting payments to the department, identifies payment discrepancies, and resolves issues accordingly. It also reviews payments to ensure that revenues are allocated properly to the various trusts under the control of the Board of University and School Lands.

The Revenue Compliance Division is also responsible for development, implementation and monitoring of the accounting, managerial and system controls used by the Department to detect and prevent the misappropriation of trust assets and revenues.

Royalty Collections

The Division reviews oil and gas royalty payments to determine if they were made in accordance with the Board's lease terms, rules and regulations, and North Dakota laws. The oil and gas royalty revenue collected during the 2011-2013 biennium was \$340,364,328. Included in this total is \$9.5 million that is a result of enhanced efforts to examine royalty reports and submittals. It is important to note that the "penalty" provision in the Department's lease is calculated at the rate of 1 percent per 30 days. The penalty is based on the time value of money, and is assessed in lieu of the Commissioner seeking interest on late royalty payments as provided for in N.D.C.C. 47-16-39.1. Although \$11.5 million was collected during the 2011-2013 biennium as

REVENUE COMPLIANCE SUMMARY			
	Fiscal Year Ended June 30, 2012	Fiscal Year Ended June 30, 2013	Total 2011-2013 Biennium
Additional Royalties Collected	\$ 5,033,003	\$ 4,511,386	\$ 9,544,389
Additional Taxes or Other Deductions Collected	\$ 541,319	\$ 743,283	\$ 1,284,602
Penalties Collected	\$ 437,279	\$ 255,346	\$ 692,625
Total Collected	\$ 6,011,601	\$ 5,480,015	\$ 11,491,616

a result of the Division's efforts, most of that amount is a result of errors and interpretations made by operating oil companies, not deliberate underpayments of royalties.

Non-Producing Leases

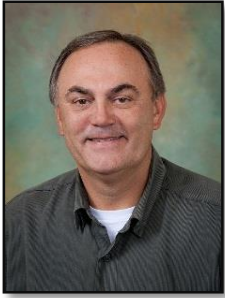
In addition to royalty collection efforts, the Revenue Compliance Division together with the Minerals Management Division has worked to identify non-producing and low-producing leases in an effort to encourage leaseholders to satisfy the terms or terminate the lease. These efforts have motivated operators to renegotiate lease terms and bring the wells back to a more productive status, or to acknowledge the lack of production and allow the lease to expire. To date, this action has resulted in 2,468 acres that were previously designated as "held by production" being made available to lease again, where they can generate new lease bonus revenues for the trusts and eventually higher production and royalty revenues.

NON-PRODUCING LEASE SUMMARY			
	Fiscal Year Ended June 30, 2012	Fiscal Year Ended June 30, 2013	Total 2011- 2013 Biennium
Acres Relinquished	2,059.86	407.95	2,467.81
Bonus Received from Relinquished Acres	\$ 0	\$ 1,298,492	\$ 1,298,492

DIVISION REPORTS

Energy Infrastructure and Impact Office

Gerry Fisher, Administrator



The Energy Infrastructure and Impact Office (EIIO), formerly known as the Energy Development Impact Office, was legislatively established in 1975 as the Coal Development Impact Office. The Oil and Gas Impact Grant Program, established to address oil and gas developments, began in 1981. In 1989 the EIIO was combined with the Department of Trust Lands, and the Office is currently under the direction of the Board of University and School Lands.

Energy Impact Grant Program

The purpose of the Energy Impact Grant Program is to provide financial assistance to local units of government experiencing adverse impacts as a direct result of oil and gas activity. The program is funded by 20 percent of the Oil and Gas Gross Production Tax. The amount of funding available to this program was capped at \$6 million during the 2007-09 biennium and increased to \$8 million the next biennium. Funding for the 2011-2013 biennium was set by the legislature at \$100 million; however, a special legislative session in November 2011 appropriated an additional \$30 million of the general fund for oil and gas impact awards, and another \$5 million was set aside for counties emerging as oil and gas producing areas. During the special session, the EIIO was also tasked with the implementation of a \$30 million Flood Impacted Political Subdivision Infrastructure Development grant program to assist political subdivisions with 2011 flood challenges.

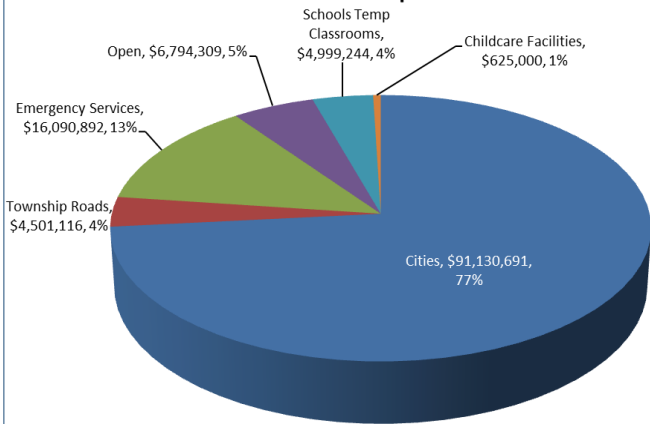
Criteria used for award consideration under the oil and gas impact program included:

- ◆ The project need as a direct result of impacts caused by oil and gas development and production;
- ◆ The safety of the public, emergency services responders and providers and others protected or improved by completion of the project;

2011-2013 Biennium Oil and Gas Impact Grant Amounts Requested and Awarded		
Summary by County		
County	Requested	Awarded
ADAMS	\$1,039,472	\$0
BILLINGS	\$4,315,174	\$697,814
BOTTINEAU	\$5,867,008	\$726,502
BOWMAN	\$5,134,264	\$363,727
BURKE	\$26,692,024	\$2,065,132
DIVIDE	\$27,361,911	\$6,019,014
DUNN	\$38,694,500	\$4,851,708
G. VALLEY	\$2,115,691	\$820,894
GRANT	\$95,000	\$0
HETTINGER	\$210,000	\$0
MCHENRY	\$678,894	\$24,978
MCKENZIE	\$72,942,810	\$21,653,157
MCLEAN	\$1,429,017	\$0
MERCER	\$13,440,730	\$272,933
MORTON	\$8,820	\$8,256
MOUNTRAIL	\$108,751,136	\$19,060,944
RENVILLE	\$9,957,131	\$485,406
SLOPE	\$1,778,351	\$158,248
STARK	\$65,008,110	\$15,470,409
WARD	\$45,019,262	\$6,356,843
WILLIAMS	\$231,672,189	\$45,259,304
TOTAL	<u>\$662,211,494</u>	<u>\$124,295,269</u>

2011-2013 Biennium - Amounts Awarded

Oil and Gas Impact Grants



- ◆ How well the focused objective of the grant round is met by the proposed project;
- ◆ The applicant demonstrating financial need upon examination of the local financial commitment, local tax levy, cash balance, debt load, unused award funds and other revenue sources;
- ◆ Project being ready and achievable based on design, planning, cost estimates and project organization being completed; and
- ◆ Completion of the project resulting in long-term economic benefit.

(continued)

DIVISION REPORTS

(Energy Infrastructure and Impact Office, continued)

During the biennium, the Energy Infrastructure and Impact Office conducted 10 grant rounds. Each fiscal year, four main grant rounds were held. One focused on city infrastructure needs (mainly potable water and sanitary sewer), a second on township roads, a third for emergency services (emergency medical, fire and law enforcement), and fourth was a general grant round for infrastructure needs of all other political subdivisions.

The program addressed several developing needs during the biennium. In FY2012, a grant round was held for K-12 schools for portable temporary classrooms to address significant student population growth. In FY2013, a pilot program was established to address childcare facility needs. During each grant round, EIIO staff spent several weeks traveling western North Dakota, meeting with political subdivision officials requesting funding. Staff also drove roads and visited the projects being impacted by oil and gas development. Information was gathered from many sources, including oil and gas production data and rig counts, oil tax and property tax information, and receipt of other state funds, as well as other financial information from the various County and City Auditors' offices.

The Land Board provided \$300,000 to match a \$1.5 million Housing and Urban Development (HUD) grant for a community planning initiative for multiple western cities and counties. This initiative assisted communities with long-range planning assistance to identify infrastructure needs that the communities may need due to oil and gas development. The Board also provided several unique grants to address emergency water, sewer and law enforcement needs.

During the special legislative session in November of 2011, an additional \$5 million was provided for counties emerging into the energy sector. A trigger was defined by the legislature, namely that counties having less than 100,000 barrels of production in November 2011 and that experienced four or more active drilling rigs in any one month following would qualify for \$1.25 million. The trigger was not met during the biennium and these general funds were not disbursed.

During the biennium over 980 grant requests for more than \$662.2 million were received and reviewed. Of the \$130 million in the Oil and Gas Impact Grant Fund, \$5 million was directly appropriated to the Department of Public Instruction for schools experiencing rapid enrollment growth, \$350,000 was directly appropriated to the Upper Great Plains Transportation Institute for a study of western road needs, and \$354,731 was authorized for program administration. The Land Board was able to approve \$124.3 million in awards to communities, counties, fire departments and schools.

The 2011 legislature authorized the Land Board to appoint an advisory committee to assist in the grant round process. This committee assisted in the review and development of recommendations for award during several grant rounds.

Flood-Impacted Political Subdivision Infrastructure Development Grants

Separate from the oil and gas impact grant program, \$30 million was appropriated by the 2011 Legislative Assembly during the November 2011 Special Session to address needs resulting from the 2011 flood events. The Energy Infrastructure and Impact Office was designated to implement a grant program to address impacts not being funded by other state or federal response or insurance coverage.

2011-2013 Biennium Flood Impacted Political Subdivision Infrastructure Development Grants Applications and Awards				
<i>Summary by County</i>				
County	No. of Apps	Requested	No. of grants	Awarded
BARNES	18	\$1,486,087	10	\$500,000
BENSON	20	\$1,069,997	20	\$1,000,000
BURLEIGH	5	\$2,685,606	5	\$2,685,606
MCHENRY	56	\$1,413,456	47	\$1,027,547
MORTON	7	\$1,479,543	5	\$1,079,749
RAMSEY	9	\$1,017,280	8	\$1,000,000
RENVILLE	9	\$1,204,614	8	\$893,682
RICHLAND	26	\$605,091	19	\$500,048
WARD	22	\$21,438,496	19	\$21,208,448
TOTAL	172	<u>\$32,400,170</u>	<u>141</u>	<u>\$29,895,080</u>

Criteria used for award consideration under the flood impacted political subdivision infrastructure development grants program included:

- ◆ Development of new community infrastructure needed to support displaced residents;
- ◆ Projects necessary to evaluate and identify the extent of flood damage to community-owned infrastructure;
- ◆ Efforts to restore or repair flood-related damage to community-owned infrastructure;
- ◆ Expansion of landfill capacity or reimburse flood-related waste disposal costs necessitated by flood-related debris;

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DIVISION REPORTS

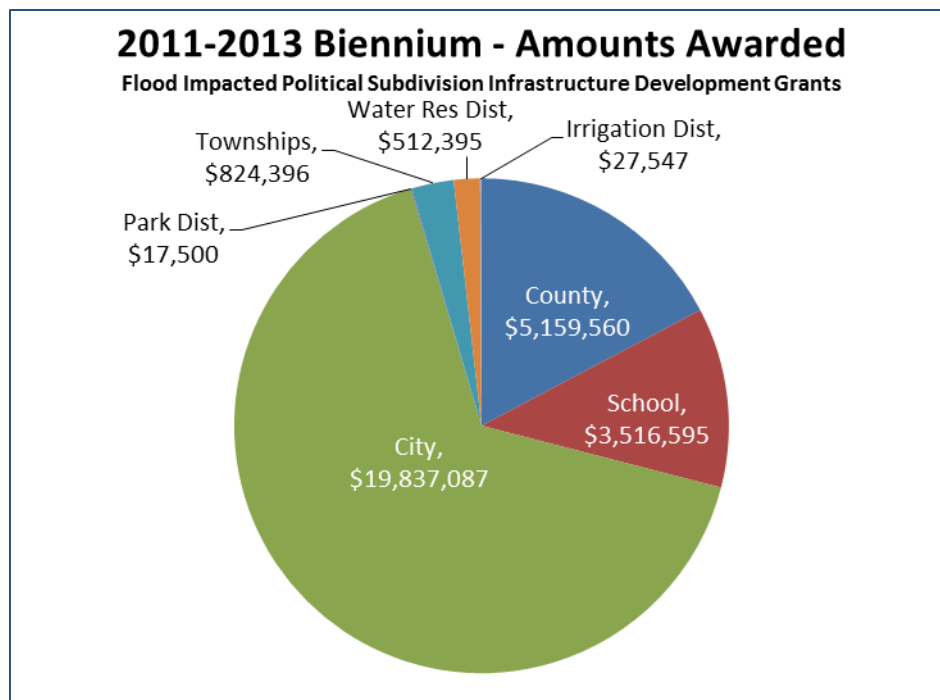
(Energy Infrastructure and Impact Office, continued)

- ◆ Projects to raise a roadway;
- ◆ Projects to acquire property needed for floodway development or levy construction;
- ◆ Acquisition of homes damaged by levee construction; and
- ◆ Projects for other flood-related damage.

Applicants were limited to political subdivisions within one of the nine FEMA declared Individual Assistance

disaster counties as a result of damages sustained in the 2011 flood: Barnes, Benson, Burleigh, McHenry, Morton, Ramsey, Renville, Richland and Ward counties.

The Land Board considered 172 applications for projects totaling more than \$105 million and approved 141 grants totaling \$29,895,080. The funds provided up to 50 percent of the project costs as required by the legislatively authorized match. Administrative costs totaled \$104,920, short of the \$110,000 allowed by the legislature. The 2013 legislature provided carryover authority on unused funding as many of the approved flood improvement projects realized difficulty finishing the work prior to the end of the biennium.



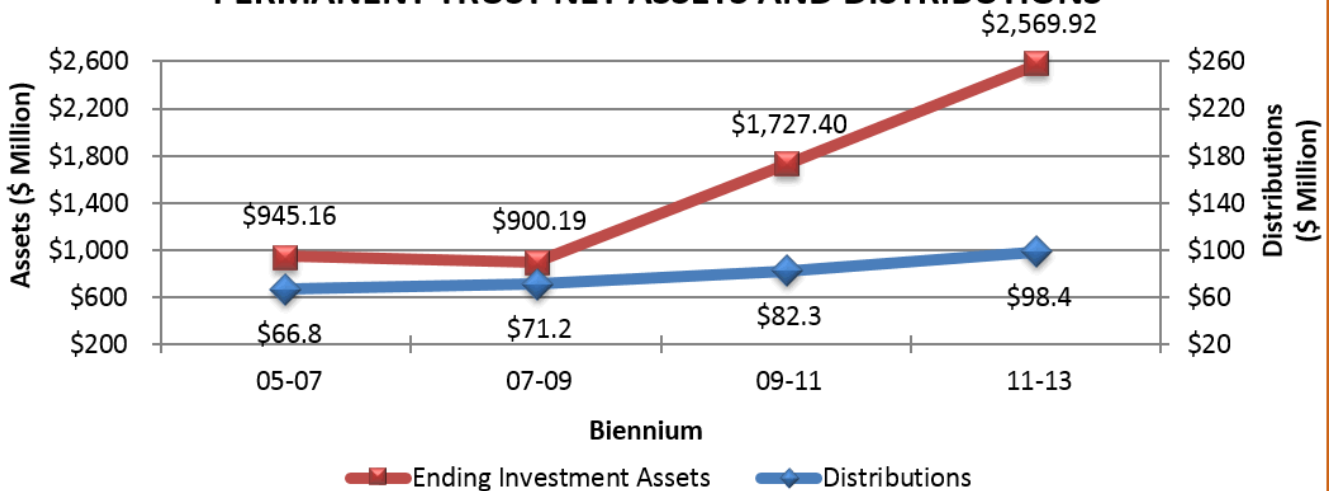
FINANCIAL REPORTS

Permanent Funds

Net Asset Balances by Trust

	6/30/2007	6/30/2009	6/30/2011	6/30/2013
Common Schools	\$887,092,909	\$846,314,086	\$1,622,412,984	\$2,417,363,782
North Dakota State University	13,997,592	12,926,989	26,211,666	40,849,758
School for the Blind	2,253,889	1,892,385	3,130,370	5,642,741
School for the Deaf	4,112,495	4,232,854	9,352,875	14,035,624
State Hospital	5,566,307	5,632,733	9,300,413	11,124,623
Ellendale State College	2,065,897	2,008,718	4,592,559	6,528,016
Valley City State University	2,902,693	2,482,888	4,453,923	6,677,677
Mayville State University	2,011,467	1,620,969	2,854,879	4,755,521
Industrial School	4,898,034	4,171,174	10,387,494	16,341,908
State College of Science	4,612,074	4,630,622	8,593,518	11,165,942
School of Mines	5,163,629	5,726,268	10,132,213	12,794,656
Veterans Home	2,744,928	2,176,905	3,035,395	4,036,445
University of North Dakota	7,741,576	6,376,620	12,942,682	18,602,001
Total	\$945,163,490	\$900,193,211	\$1,727,400,971	\$2,569,918,694

PERMANENT TRUST NET ASSETS AND DISTRIBUTIONS



Distributions by Trust

	7/05 to 6/07	7/07 to 6/09	7/09 to 6/11	7/11 to 6/13
Common Schools	\$62,200,000	\$66,800,000	\$77,178,000	\$92,514,000
North Dakota State University	1,146,000	1,070,000	1,238,000	1,424,000
School for the Blind	208,000	176,000	206,000	216,000
School for the Deaf	322,000	310,000	360,000	454,000
State Hospital	310,000	390,000	456,000	572,000
Ellendale State College	235,200	168,000	196,000	220,003
Valley City State University	268,000	226,000	260,000	286,000
Mayville State University	176,000	156,000	178,000	184,000
Industrial School	404,000	378,000	438,000	528,000
State College of Science	306,000	338,000	388,000	492,000
School of Mines	322,000	370,000	428,000	560,000
Veterans Home	236,000	214,000	248,000	248,000
University of North Dakota	664,000	604,000	692,000	750,000
Total	\$66,797,200	\$71,200,000	\$82,266,000	\$98,448,003
Increase From Previous Biennium	3.5%	6.6%	15.5%	19.7%

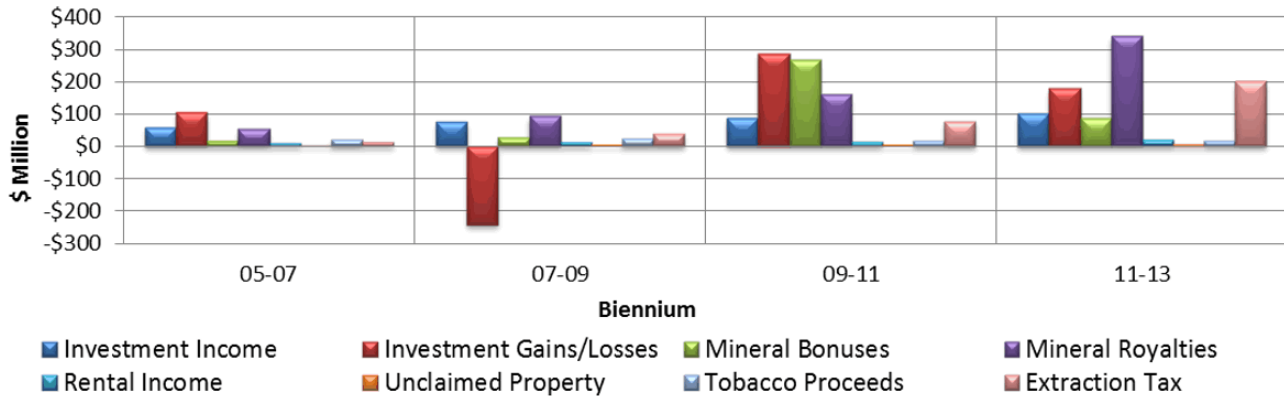
FINANCIAL REPORTS

Permanent Funds

Permanent Trust Revenues by Trust

	7/05 to 6/07	7/07 to 6/09	7/09 to 6/11	7/11 to 6/13
Common Schools	\$268,643,921	\$34,050,810	\$863,203,537	\$899,547,681
North Dakota State University	4,097,965	140,150	14,714,384	16,320,293
School for the Blind	532,019	(161,898)	1,476,307	2,770,039
School for the Deaf	1,310,849	471,578	5,544,552	5,224,176
State Hospital	2,217,502	500,736	4,181,005	2,461,790
Ellendale State College	536,563	140,076	2,820,533	2,205,740
Valley City State University	824,788	(159,071)	2,279,205	2,564,651
Mayville State University	597,658	(211,092)	1,443,349	2,123,213
Industrial School	1,261,391	(299,223)	6,731,725	6,590,087
State College of Science	1,710,127	391,484	4,410,980	3,134,279
School of Mines	1,973,697	978,275	4,898,211	3,298,466
Veterans Home	643,546	(329,200)	1,136,568	1,281,524
University of North Dakota	1,943,142	(684,718)	7,362,237	6,444,075
Total	\$286,293,168	\$34,827,907	\$920,202,593	\$953,966,014

SOURCES OF PERMANENT TRUST REVENUES



Permanent Trust Revenues by Source

	7/05 to 6/07	7/07 to 6/09	7/09 to 6/11	7/11 to 6/13
Investment Income	\$59,709,979	\$74,967,590	\$88,258,418	\$100,417,162
Investment Gains/Losses	104,527,401	(242,259,582)	286,647,894	178,153,865
Mineral Bonuses	17,138,675	27,660,236	268,760,195	87,628,350
Mineral Royalties	53,541,895	93,203,034	159,652,727	340,364,328
Mineral Rentals	971,224	1,020,914	1,404,486	754,167
Surface Rentals	10,116,534	11,579,335	13,899,500	19,698,331
Unclaimed Property	4,397,774	6,001,464	5,724,147	8,168,244
Tobacco Proceeds	22,753,729	24,753,324	18,102,049	18,024,419
Extraction Tax	13,135,957	37,901,592	77,753,177	200,757,148
Total	\$286,293,168	\$34,827,907	\$920,202,593	\$953,966,014

FINANCIAL REPORTS

Other Funds

	<i>Net Asset Balances</i>		<i>Distributions</i>	
	<i>6/30/11</i>	<i>6/30/13</i>	<i>7/09 to 6/11</i>	<i>7/11 to 6/13</i>
Capitol Building Trust Fund	\$3,367,502	\$2,841,003	\$106,700	\$1,809,000
Coal Development Trust Fund	63,449,567	65,300,138	2,505,172	1,898,390
Strategic Investment & Improvements Fund	249,074,431	969,920,162	35,814,077	305,000,000
Indian Cultural Education Trust	667,591	759,091	-	-
Total	\$316,559,091	\$1,038,820,394	\$38,425,949	\$308,707,390

	<i>Other Funds Revenue by Source</i>			
	<i>Strategic Investment & Improvements Fund</i>	<i>Capitol Building Trust Fund</i>	<i>Coal Development Trust Fund</i>	<i>Indian Cultural Education Trust</i>
Investment Revenue	\$2,065,673	\$21,249	\$2,012,089	\$92,317
Mineral Bonuses	106,922,161	28,539	-	-
Mineral Royalties	138,293,182	956,004	-	-
Rental Income	359,505	326,546	-	4,000
Tax Income	786,998,032	-	6,230,589	-
Total	\$1,034,638,553	\$1,332,338	\$8,242,678	\$96,317