

## COMMON SCHOOLS TRUST FUND - RELATED CONSTITUTIONAL AND STATUTORY PROVISIONS - ASSETS AND DISTRIBUTIONS

This memorandum summarizes:

- Select constitutional and statutory provisions relating to money deposited in the common schools trust fund.
- Select constitutional and statutory provisions relating to distributions from the common schools trust fund.
- Statutory provisions relating to the investment of the common schools trust fund.
- Actual and projected assets, distributions, and investment returns for the common schools trust fund.
- Information regarding the state tuition fund.

### MONEY DEPOSITED IN THE COMMON SCHOOLS TRUST FUND Select Constitutional Provisions

#### Article IX - Section 1

This section provides that the following money must be deposited in a permanent trust fund, known as the common schools trust fund, and used to support the common schools of the state:

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

This section was included in the original Constitution of North Dakota enacted in 1889. In 1982 the section was amended to provide that bonuses relating to the leasing of coal, gas, oil, or other mineral interests relating to common schools lands were to be deposited in the common schools trust fund.

#### Article IX - Section 5

This section provides that in all sales of common schools lands, the state must retain the mineral interests. Leases may be executed for the extraction and sale of the minerals.

This section was included in the original Constitution of North Dakota enacted in 1889. As originally enacted, the section prohibited the sale of common schools lands that were "coal lands" and did not address other minerals. In 1960 the section was amended to its current form which allows the sale of lands containing minerals but requires that the state retain the mineral interests. Minerals are defined to

include oil, gas, coal, cement materials, sodium sulphate, sand and gravel, road material, building stone, chemical substances, metallic ores, uranium ores, and colloidal or other clays.

#### Article X - Section 24

This section provides that 10 percent of oil extraction tax revenue must be deposited in the common schools trust fund.

This section was enacted in 1994 through voter approval of measure No. 1 (1993 Senate Concurrent Resolution No. 4011). The section has not been changed since enactment.

### Select North Dakota Century Code Provisions Section 47-30.1-23

This section provides that all funds received by the state under the Uniform Unclaimed Property Act, except amounts deducted for the payment of claims and certain administrative costs, must be deposited in the common schools trust fund.

#### Section 54-27-25

This section, which was enacted by the 1999 Legislative Assembly, creates a tobacco settlement trust fund to be used to deposit tobacco settlement money received by the state. Forty-five percent of the money in the fund must be transferred to the common schools trust fund and become a part of the principal of the fund. The interest and other income relating to this money are distributed to schools along with other interest and income or retained in the fund, pursuant to North Dakota Century Code Section 15-03-05.2, at the discretion of the Board of University and School Lands.

To date, \$88,503,874 of tobacco settlement money received by the state has been transferred to the common schools trust fund. The remaining transfers are estimated to total \$258,645,282. The following is a summary of transfers to the common schools trust fund from the tobacco settlement trust fund:

1999-2001	\$23,805,353 (actual)
2001-03	\$23,998,745 (actual)
2003-05	\$20,977,123 (actual)
2005-07	\$19,722,653 (actual)
2007-09	\$31,501,306 (estimate)
2009-11	\$33,159,270 (estimate)
2011-17 (\$33,159,270 per biennium)	\$99,477,810 (estimate)
2017-25 (\$23,626,724 per biennium)	\$94,506,896 (estimate)

## **DISTRIBUTIONS FROM THE COMMON SCHOOLS TRUST FUND**

### **Select Constitutional Provisions**

#### **Article IX - Section 1**

This section provides that only the interest and income, not the principal, of the trust fund may be expended.

This section was amended in November 2006 through voter approval of measure No. 1 (2005 House Concurrent Resolution No. 3037); however, the amended section has not yet become effective. The measure will change the way distributions from the common schools trust fund and other permanent educational trust funds are determined. Distributions are currently based on the amount of interest and income earned by each trust during a fiscal year. The measure provides that biennial distributions from each educational trust fund will be 10 percent of the five-year average value of the trust assets, excluding the value of land and minerals. For example, for the 2009-11 biennium, the estimated five-year average value of the common schools trust fund assets, excluding the value of lands and minerals, is \$780,434,585; therefore, distributions of 10 percent of the five-year average would be \$78,043,459. The measure is intended to allow the Board of University and School Lands to make long-term investment decisions that emphasize maintaining the purchasing power of the trusts while also providing stable and reliable distributions to beneficiaries.

The measure has a contingent effective date. Section 3 of 2005 House Concurrent Resolution No. 3037 provides that if approved by the voters, the measure becomes effective on July 1 following the date on which the Attorney General certifies to the Secretary of State that the United States Congress has by amendment removed all inconsistent provisions found in the 1889 Enabling Act and the 1862 Morrill Act. The Board of University and School Lands is working with the state's Congressional Delegation to pass federal legislation that will allow the state to implement the measure. At the present time, the federal legislation has not been acted upon. The board anticipates the legislation will pass during 2008 and anticipates implementing provisions of the measure for the 2009-11 biennium.

#### **Article IX - Section 2**

This section provides that payments to the common schools of the state include:

- Interest and income from the common schools trust fund.
- All fines for violation of state laws. (This money is not added to the trust fund but is distributed to schools along with the interest and income from the trust fund.)
- All other amounts provided by law.

This section was included in the original Constitution of North Dakota enacted in 1889. The original law contained the following two provisions that

were removed through voter approval of measure No. 3 in June 1982:

- Payments to the common schools must be distributed in proportion to the number of school-age children in each district.
- Any portion of the interest or income of the common schools trust fund not distributed during a fiscal year must be added to the permanent balance of the trust fund. (North Dakota Century Code Section 15-03-05.2 provides that the Board of University and School Lands can add excess income to the trust fund balance or retain it for distribution in a future year.)

#### **Select North Dakota Century Code Provisions**

##### **Section 15-01-02**

This section provides that the Board of University and School Lands has full control of:

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

##### **Section 15-03-05.2**

This section provides that the Board of University and School Lands may distribute only that portion of a fund's income that is consistent with the long-term goals of preserving the purchasing power of the fund and maintaining income stability. If the amount of income earned in a fiscal year exceeds the amount distributed during the preceding fiscal year, the board has the following three options for the use of the additional income:

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

## **INVESTMENT OF THE COMMON SCHOOLS TRUST FUND**

North Dakota Century Code Section 15-03-04 provides that the Board of University and School Lands is to apply the prudent investor rule in investing the permanent funds under its control, including the common schools trust fund. The prudent investor rule means that in making investments, the board is to exercise the same judgment and care that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it.

The board's long-range strategy for the investment of the common schools trust fund is to have both principal and income grow at a rate greater than, or equal to, the rate of inflation. In order to accomplish

this goal, the board has adopted an asset allocation plan that includes a 49 percent allocation to a diversified portfolio of fixed income investments and a 51 percent allocation to a diversified portfolio of equities and convertible securities. The strategy and asset allocation plan were recommended to the board by an investment consultant in a study performed in 2003.

## ACTUAL AND PROJECTED ASSETS, DISTRIBUTIONS, AND INVESTMENT RETURNS FOR THE COMMON SCHOOLS TRUST FUND

The following is a summary of actual and projected assets, distributions, and investment returns for the common schools trust fund for the bienniums 1997-99 through 2011-13:

Biennium	Fiscal Year	Beginning Assets (Excluding Land and Minerals Values)	Distributions <sup>1</sup>	Investment Income (Interest Income Only)	Total Average Investment Return (Interest Income and Capital Gains)
1997-99	1998	\$400,689,879	\$23,200,000	\$24,965,697	13.57%
	1999	\$444,823,559	\$23,200,000	\$24,644,625	7.50%
1999-2001	2000	\$467,059,293	\$23,775,000	\$25,650,676	11.05%
	2001	\$521,509,978	\$23,775,000	\$27,382,227	2.03%
2001-03	2002	\$533,360,593	\$28,896,500	\$26,548,262	(1.34%)
	2003	\$522,905,814	\$28,896,500	\$26,620,380	4.57%
2003-05	2004	\$547,047,877	\$30,000,000	\$24,849,254	12.60%
	2005	\$614,738,548	\$30,000,000	\$26,137,010	8.58%
2005-07	2006	\$686,273,875	\$31,100,000	\$27,118,113	7.51%
	2007	\$759,975,860	\$31,100,000	\$31,378,257	12.82%
2007-09	2008	\$884,694,539	\$33,400,000	\$35,387,782 (estimate)	8.00% (estimate)
	2009	\$956,490,102 (estimate)	\$33,400,000	\$38,259,604 (estimate)	8.00% (estimate)
2009-11	2010	\$1,033,029,310 (estimate)	\$39,021,729 (estimate)	\$41,321,172 (estimate)	8.00% (estimate)
	2011	\$1,109,995,526 (estimate)	\$39,021,729 (estimate)	\$44,399,821 (estimate)	8.00% (estimate)
2011-13	2012	\$1,193,185,951 (estimate)	\$47,441,853 (estimate)	\$47,727,438 (estimate)	8.00% (estimate)
	2013	\$1,274,679,736 (estimate)	\$47,441,853 (estimate)	\$50,987,189 (estimate)	8.00% (estimate)

<sup>1</sup>The Board of University and School Lands' goal is to distribute only the income projected to be earned by the common schools trust fund and not to distribute realized capital gains, which are amortized to income over 10 years. Some years it has been necessary for the board to distribute realized capital gains to meet budgeted distributions.

### STATE TUITION FUND

North Dakota Century Code Section 15.1-28-01 provides that the state tuition fund consists of the net proceeds from all fines for violation of state laws and distributions from the common schools trust fund. Section 15.1-28-03 directs the Office of Management and Budget, on or before the third Monday in January, February, March, April, August, September, October, November, and December of each year, to certify to the Superintendent of Public Instruction the amount of the state tuition fund.

Beginning with the 2007-09 biennium, the Superintendent of Public Instruction will include the money in the tuition fund in state school aid payments to school districts as determined by Chapter 15.1-27. Previously, the Superintendent apportioned the money in the tuition fund among the school districts in the state based on the number of school-age children in the district.

The following is an analysis of the state tuition fund for the 2007-09 biennium:

Beginning balance		\$1,133,040 <sup>1</sup>
Add estimated revenues		
Fines for violation of state laws	\$9,400,000 <sup>2</sup>	
Transfers from the common schools trust fund	66,800,000	
Total estimated revenues		76,200,000
Total available		\$77,333,040
Less estimated expenditures and transfers		
State aid to schools	76,200,000 <sup>3</sup>	
Estimated ending balance		\$1,133,040 <sup>1</sup>

<sup>1</sup>North Dakota Century Code Section 15.1-28-03 provides for the distribution of money in the state tuition fund in August, September, October, November, December, January, February, March, and April of each year. Fines proceeds deposited in the tuition fund during May and June of each fiscal year are carried forward for distribution in August of the subsequent year.

<sup>2</sup>The amount of state tuition fund distributions from fines proceeds is shown below:

<b>Fiscal Year</b>	<b>Revenues From Fines</b>	<b>Percentage Increase From Previous Year</b>
1998	\$3,384,890 (actual)	
1999	\$3,818,890 (actual)	12.8%
2000	\$4,866,644 (actual)	27.4%
2001	\$4,241,256 (actual)	(12.9%)
2002	\$4,778,756 (actual)	12.7%
2003	\$4,607,423 (actual)	(3.6%)
2004	\$4,721,407 (actual)	2.5%
2005	\$4,507,137 (actual)	(4.5%)
2006	\$4,506,316 (actual)	(0.01%)
2007	\$4,590,395 (actual)	1.9%
2008	\$4,700,000 (estimate)	2.4%
2009	\$4,700,000 (estimate)	0.0%

<sup>3</sup>The 2007 Legislative Assembly, in Senate Bill No. 2200, consolidated funding for the state school aid program, including per student payments, teacher compensation payments, special education average daily membership payments, revenue supplemental payments, and tuition apportionment payments, into a new state school aid funding formula with a new distribution methodology.