

MINUTES
REGULAR MEETING OF THE BOARD OF LAND COMMISSIONERS
Tuesday, January 17, 2012, at 9:00 a.m.
State Capitol
Helena, MT

PRESENT: *Governor Brian Schweitzer, Attorney General Steve Bullock, Commissioner of Securities and Insurance Monica Lindeen, Secretary of State Linda McCulloch, Superintendent of Public Instruction Denise Juneau*

Ms. McCulloch moved for approval of the minutes from the December 19, 2011, meeting of the Board of Land Commissioners. Seconded by Mr. Bullock. Carried unanimously.

BUSINESS DISCUSSED

112-1 HIGHWAY 93 CORRIDOR TIMBER SALE

Mary Sexton, DNRC Director, stated the timber sale is located 18 miles northwest of Whitefish within the wildland-urban interface (WUI) along Highway 93. It is 182-acre fuel reduction project (1.3 MMBF). There has been extensive public involvement.

Motion made by Ms. Lindeen to approve the timber sale. Seconded by Mr. Bullock. Motion carried unanimously.

112-2 PRELIMINARY APPROVAL FOR LAND BANKING PARCELS

Ms. Sexton stated that over one-third of the land in Daniels County is state trust land. DNRC has done extensive review and worked with lessees, land owners, and citizens in the area. This will be the first round of preliminary approval for land banking in Daniels County. At present DNRC staff in Glasgow has been working on getting 7288 acres nominated for land banking. That is actually only three percent of the DNRC holdings in Daniels County. The tracts are almost all lessee nominated; however, there are three vacant DNRC-nominated parcels. These parcels are mostly split use between agriculture and grazing with 4400 grazing acres and 2800 acres of agriculture land. Two housing sites are also included in this transaction.

Motion made by Ms. Juneau for preliminary approval. Seconded by Ms. McCulloch.

Mr. Bullock asked how the state acquired one-third of Daniels County.

Ms. Sexton said that in portions of western Montana were already national and state forests upon statehood, so the trust was unable to be granted certain sections 16 and 36. Some of those other sections in Daniels County were parcels that had not been claimed by anyone. Also, the Fort Peck Tribe was already in existence at the time of statehood, so those sections 16 and 36 were under tribal ownership. In addition to the blocks in Daniels County, there is an isolated block of land consisting of 30,000 acres in Valley County.

Mr. Bullock asked what are the next steps in the process are.

Ms. Sexton said DNRC is continuing to go through and analyze the other state-owned parcels in Daniels County. DNRC will continue to work with lessees and will bring another few batches of parcels for preliminary approval over the next year.

Mr. Bullock asked if the state is going to reserve subsurface rights.

Ms. Sexton said yes, the state will reserve subsurface ownership. Some of these parcels do have access, but with the number of roads in Daniels County access tends to be along the section line. DNRC will be getting blocked up access, much like the Tongue River Ranch in Custer County, which is 17,000 acres of blocked up land that gets a good return on investment (ROI), provides good access, and is much easier to manage (see [February 20, 2007, Land Board minutes](#)).

DNRC has not struggled with access in Daniels County, but there are so many lessees that overseeing, managing, and getting a good ROI while making sure that all the production statistics are accurate is difficult. There are better opportunities for the state elsewhere. The county will get some taxes on this property with it going to private ownership. Right now, Daniels County does not get much of anything from the state in the sense of taxes.

Mr. Bullock said he has consistently been concerned with selling off parcels that have public access; but, when you look at Daniels County there is such a high percentage of trust land. Also the county has the need to get some tax revenues.

Ms. Sexton said the high percentage of trust land really is an anomaly.

Governor Schweitzer said if you look at the rest of the counties in the state, the percentages of state land per county are somewhere between five and eight percent. In terms equalization, it probably would make great deal of sense for the state to decrease its ownership in Daniels County and increase ownership in other counties. It is very difficult to manage the Daniels county parcels for the best ROI since they are not blocked up. In recent years the state looked for opportunities to block state land for: better ROI; better opportunities for hunting, camping and fishing; and to allow county governments to have a fair disposition of those resources. Daniels County is shorted funds that they might otherwise have as property taxes.

This first proposed land banking sale is only 7000 acres. In order to get to equalization, the state will have to look at selling between 30,000 and 80,000 acres. This is a great time to sell farmland since farmland in eastern and northeastern Montana has doubled in value in the last ten years. It gives the state an opportunity to sell high and buy in some other pockets across Montana. Governor Schweitzer noted that this does not necessarily mean the Land Board will sell in eastern Montana and buy in western Montana. It does mean that it will sell in Daniels County and buy in Valley, Richland, Hill and Fergus counties. The state will get an asset that is worth more for the future of Montana.

Motion for preliminary approval for the sale of land banking parcels in Daniels County carried unanimously.

112-3

FINAL APPROVAL FOR SALE OF LAND BANKING PARCELS:
A. DAWSON COUNTY

Ms. Sexton stated the parcel in Dawson County is located five miles southeast of Glendive and consists of one full section of land. The minimum bid was \$150 per acre and it was sold at public auction on December 14, 2011, for a total of \$96,000.

Motion made by Ms. Lindeen for final approval of the parcels in Dawson County. Seconded by Ms. McCulloch. Motion carried unanimously.

B. ROSEBUD COUNTY

Ms. Sexton said there are two parcels in Rosebud County 25 miles north of Hysham. They were below average productivity and inaccessible. The minimum bid for these was \$150 per acre and they were sold December 13, 2011, for \$143,000.

Motion made by Ms. McCulloch final approval of the parcels in Rosebud County. Seconded by Ms. Juneau. Motion carried unanimously.

112-4

EASEMENTS:

A. RIGHTS-OF-WAY

Ms. Sexton stated in addition to the regular easement applications, there is the Britz amended easement from Whitefish. It is a private-access road easement that was previously granted, although the road was very poor access. The Britz's wanted improved access that actually increased acreage. DNRC gave them credit for their for the acreage that was purchased under the old access because of the safety factor, and they will be compensating the state for their home in Whitefish.

Motion made by Ms. Lindeen to approve the easement applications. Seconded by Ms. McCulloch. Motion carried unanimously.

B. BLM RECIPROCAL ACCESS AGREEMENT – NO NAME CREEK

Ms. Sexton stated this is part of the reciprocal access between DNRC and the Bureau of Land Management (BLM). This is an existing road that will be in consort with the Habitat Conservation Plan (HCP) requirements. After this exchange the state will owe BLM \$9700 on the balance sheet.

Motion made by Ms. McCulloch to approve the reciprocal access agreement. Seconded by Ms. Juneau. Motion carried unanimously.

INFORMATION ITEM

112-5 **FISCAL YEAR 2011 HIGHLIGHTS**

Shawn Thomas, Trust Land Division Administrator, gave a presentation of the fiscal year 2011 highlights (see Related Materials, Attachment 1).

Minerals Management Bureau

Total revenue was over \$40 million for the Minerals Management Bureau. Discounting the increase from Otter Creek bonus bid (see [March 18, 2010, Land Board minutes](#)), that is still a 28% increase from 2010 revenue. Auctions alone in 2011 brought in almost \$14 million which is a 74% increase from 2010 and a 9% increase for 2009. Over \$11.5 million in oil and gas leasing has already been generated from the Bakken formation, and eastern and west-central Montana. Coal royalties were over \$8.5 million which was a 70% increase over FY 2010.

There is also a pending district court decision regarding the challenge of the issuance of the Otter Creek leases. Arch Coal continues to gather information and put together their work that they need to do for the MEPA analysis for the mining proposal, they are also engaged with the Northern Cheyenne Tribe in discussing the operating plan that is required for the terms of the settlement between the board and the Northern Cheyenne Tribe.

Agriculture and Grazing Bureau

The Agriculture and Grazing Bureau brought its total revenues of \$14 million, with grazing alone bringing in \$6.5 million. The AUM rate for 2011 was \$6.23; minimum rates are calculated every year using a multiplier against the Montana beef cattle prices. Due to an amendment to the multiplier approved by the Land Board in November 2011 (effective December 9, 2011), a new rental rate will be phased-in beginning in 2012.

Ms. Sexton said that generally speaking, DNRC has not received much feedback or comment now that the increase has actually gone into effect.

Mr. Thomas noted that the commodities market for wheat and barley increased from 2008 to 2009, dropped off some in 2010, and have been recovering between 2011 and 2012. Beef cattle prices show a similar scenario, flat to slightly increasing between 2007 and 2008, down a little in 9 and recovering in 2010 and a pretty robust recovery in 2011.

Forest Management Bureau

The Forest Management Bureau sold 63.7 MMBF, which included 26 timber sales and 40 additional timber permits. About \$8.6 million in revenue was generated, which was up slightly from 2009/2010. 2009 (\$7.6 million) was the worst year the bureau had seen in a long time. DNRC collected an additional \$1.9 million in forest improvement fees which goes into acquiring legal access, planting, thinning, and other activities that go back into the land. The Land Board approved the record of decision for the HCP with the U.S. Fish and Wildlife Service (USFWS) in December, so DNRC is busy working on implementation and tracking of data related to the HCP going forward.

Ms. Sexton said DNRC will be working with its stakeholders in both the industry and in the conservation groups as to monitoring each year, and collectively every five years. The HCP is going to be something that the USFWS, the stakeholders, and DNRC are going to be working on for many years into the future.

Mr. Thomas stated the standard general overall for the lumber market shows that in 2005, the lumber market was not doing well, sliding off more in 2008 and 2009. Presently prices are holding steady despite the fact that the overall market is still slowing.

In FY 2011 DNRC also issued a land use license to salvage the submerged logs in Flathead Lake at Sommers Bay, which is a unique project. This project is ongoing and is largely dependent on the recovery of the high end housing markets to see how viable it actually is. Production is very slow, and therefore the company needs a good niche market to justify the expenditures to recover this material.

Real Estate Management Bureau

The Real Estate Management Bureau shows that revenues are up 4% from 2010 to a little over \$11 million. Most of the categories were consistent with past years but where we did see an increase was in residential leases because of the implementation of the of the May 2010 amended administrative rules ("Alternative 3B").

DNRC did begin to see an increase in revenue of about 7% in 2011. Navigable River siting funds were up 6% as well.

Land banking sales were substantial with an average ROI of 0.5%. There were several major land banking purchases in 2010:

- Chamberlain Creek which is almost 15,000 acres in the Blackfoot (former Plum Creek Land) good timber lands with a lot of secondary growth and a lot of future potential for good timber management;

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- Phase 1 of the North Swan Purchase which was a little less than 2,000 acres; and
- the Potomac Purchase, which was a major accomplishment of 32,000 acres in the Potomac Valley.

Several major land exchanges also took place in FY 2011.

- DNRC Southwestern Land Office completed several major U.S. Forest Service exchanges in the Lolo area they had been working on for the last ten years.
- There were also two exchanges with the Confederated Salish and Kootenai Tribes (CSKT) out of the Northwestern Land Office exchanging over 4000 acres of land. It was a great deal for both the state and the CSKT.
- There was also a small land exchange with the Prairie Elk Colony.

Ms. Sexton said CSKT seems to be very interested in future land exchanges and DNRC is looking at opportunities as part of the Reserved Water Right Compact settlement. There could be land exchanges involved in that in a three-way exchange with the federal government. The tribe was very happy with this exchange, which is why they would like to continue with more.

Mr. Thomas said that both fiscal year and calendar year 2011 proved to be a busy years for the cabinsite lease program, starting with the Alternative 3B rules in 2010. The 2011 Legislature passed SB409, which caused DNRC to begin rulemaking again. The potential for vacancy was a much discussed point in this whole scenario. As it turns out, vacancy rates are pretty much what DNRC thought they would be today. DNRC will be accepting bid applications to go down that road, pending any legal action in the near future.

Ms. Sexton said with the new amended administrative rules (effective January 13, 2012) were based off SB409, which has been challenged by Montanans for the Responsible Use of School Trust Land on Friday (*MonTrust v. State of Montana, ex rel. State Legislature, Board of Land Commissioners, and Department of Natural Resources and Conservation*, BDV-12-39). Following the previous rules under Alternative 3B, the trust would earn approximately \$3 this year, most of which goes to Montana Tech (one-third goes to Common Schools, and Montana State University). With the lease bid method under the SB409 rules, DNRC is expecting that most bids will be in the 2% range and DNRC will earn only a little more than half of the \$3 million projected under Alternative 3B. This cabinsite program is unlike the other programs in that the revenue is decreasing.

Mr. Thomas gave the Land Board his sincere thanks for all their support and encouragement throughout 2011. There were a lot of controversial and difficult things brought before the board, and DNRC appreciates the thoughtfulness and the decisions made.

Ms. Sexton also thanked the board. Oil and gas has brought a lot of interest, and as far as trust lands, it has been a significant revenue increase. There continues to be questions as to where is all this going. There have been a lot of leases along the Rocky Mountain Front, which has been sort of a "mini-Bakken" type of opportunity. The real story is in the eastern part of the state: 45,000 wells drilled with 4400 wells that are producing for oil wells and gas wells are somewhat declining and that has to do with coal bed methane (CBM) production.

When it comes to producing areas and exploration activities, everyone should pay attention to the "wading pool" which is Montana and the giant "Olympic sized swimming pool" which is North Dakota. Near the state line, there is the Bakken pool, the middle

Bakken, and the Three Forks Pay Variation of the Bakken. DNRC has been developing a lot of areas such as Richland County and the vicinity, but the projected outlook really is in North Dakota instead of Montana.

Governor Schweitzer stated that the Three Forks (which is under the lower Bakken) may even be the larger producer than the Bakken. He said that people drill for oil in places where there is oil, which is why they are drilling much more in North Dakota. Once they hit oil, they will continue drilling in concentric rings around the initial zone.

DNRC is increasing the number of acres leased in Montana at one of the fastest rates in history, and at the highest lease rates. Some geologists believe there may be other shales beside the Bakken across the Rocky Mountain Front in Montana—only time will tell. The secret is out that Montana is the "wading pool" and North Dakota is the "deep end" of the pool. Hopefully with new explorations, some wildcat wells, hydraulic fracturing, and some additional shales across east and central Montana, Montana may discover another Bakken or Three Forks. In the meantime, the action will be in North Dakota.

Governor Schweitzer said that former Governor Ed Schafer of North Dakota is proposing to lower the oil and gas taxes in North Dakota. Mr. Schafer describes North Dakota as having the highest oil and gas taxes of all the lower 48 states. Only Alaska has a higher tax rate than North Dakota. Governor Schweitzer said that people say that if Montana lowers oil and gas taxes, then there will be more oil production. However, North Dakota has increased their production at the fast rate in the country (they just exceeded 500 million barrels) and they are the hottest place in the United States to drill. Montana, according to the former Governor of North Dakota, has a tax rate that is 20% lower than North Dakota. Montana has a pretty good tax system overall according to the tax foundation. Montana has the sixth best overall taxes for business. North Dakota is not far behind at twentieth. Governor Schweitzer stated that to increase oil and gas production in the state Montana probably does not need to lower our taxes—it needs more oil and gas. North Dakota takes approximately 400 days to process a permit where Montana takes less than 100 days for permitting an oil and gas well. By statute Montana has a period of time that is a quarter as long as North Dakota. Governor Schweitzer reiterated that what Montana needs to do is find more oil.

Governor Schweitzer asked if the current revenues for trust land are greater than other times in history.

Mr. Thomas said he is not exactly sure what has gone on in many years past or other points of history. The comparison to the last eight to ten years is very impressive in terms of the revenue that has been generated. Surely in terms of the most recent period of times is vastly better in many categories than historical revenues.

Ms. Sexton added that recently there have been some unusual circumstances, in the last four years such as the Otter Creek leases, increases in oil and gas leasing, wind energy leases, hydroelectric leases, right-of-way packages, and land exchanges. Some of the value from these actions are immediate to the trust, while others are more long term. The generation of revenue from Land Board action from 2009 to 2011 is almost \$300 million which is really quite phenomenal. A lot of that is due to oil and gas, but there also increases in grazing, right-of-way packages, and state land acquisitions. The actions of the last four years are going to lead to long term revenue increases, better stewardship, more access. The contributions to the trust have been very significant.

Governor Schweitzer said he was recently contacted by a journalist from Kansas. The Kansas Legislature is contemplating creating a rainy day fund. Many states asking how

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Montana has a \$400 million surplus a time when most states and the federal government seem to be broke. Montana also has approximately \$800 million in the coal trust, which is the equivalent to a rainy day fund in the sense that a majority of the Legislature can vote to tap those funds. Of course, Montana has only every had to tap that fund once, for a very brief time.

Montana also has assets the entire world would like to have in their portfolio: 5 million plus acres of timber land, grazing land, agricultural land, coal, and oil and gas, and hard rock minerals. So Montana has a \$1.7 billion annual budget, but \$400 million surplus, \$800 million in our "savings account", and about \$3 billion of land assets. Some would say that all western states have land that was granted at statehood. That is true, but many of those states sold their land. Montana has never sold its land. Montana continues to maintain the land that was given to it at statehood. Montana has not dumped its assets, but has grown them. Land boards throughout the state's history have managed to hold onto the lands. Even in tough times they did not start selling off pieces. Governor Schweitzer said Montana is in better shape than any other state in America, and that that Montana should be proud.

**Motion to adjourn made by Governor Schweitzer. Seconded by Ms. McCulloch.
Motion carried unanimously.**

Trust Lands

FY 2011 Highlights



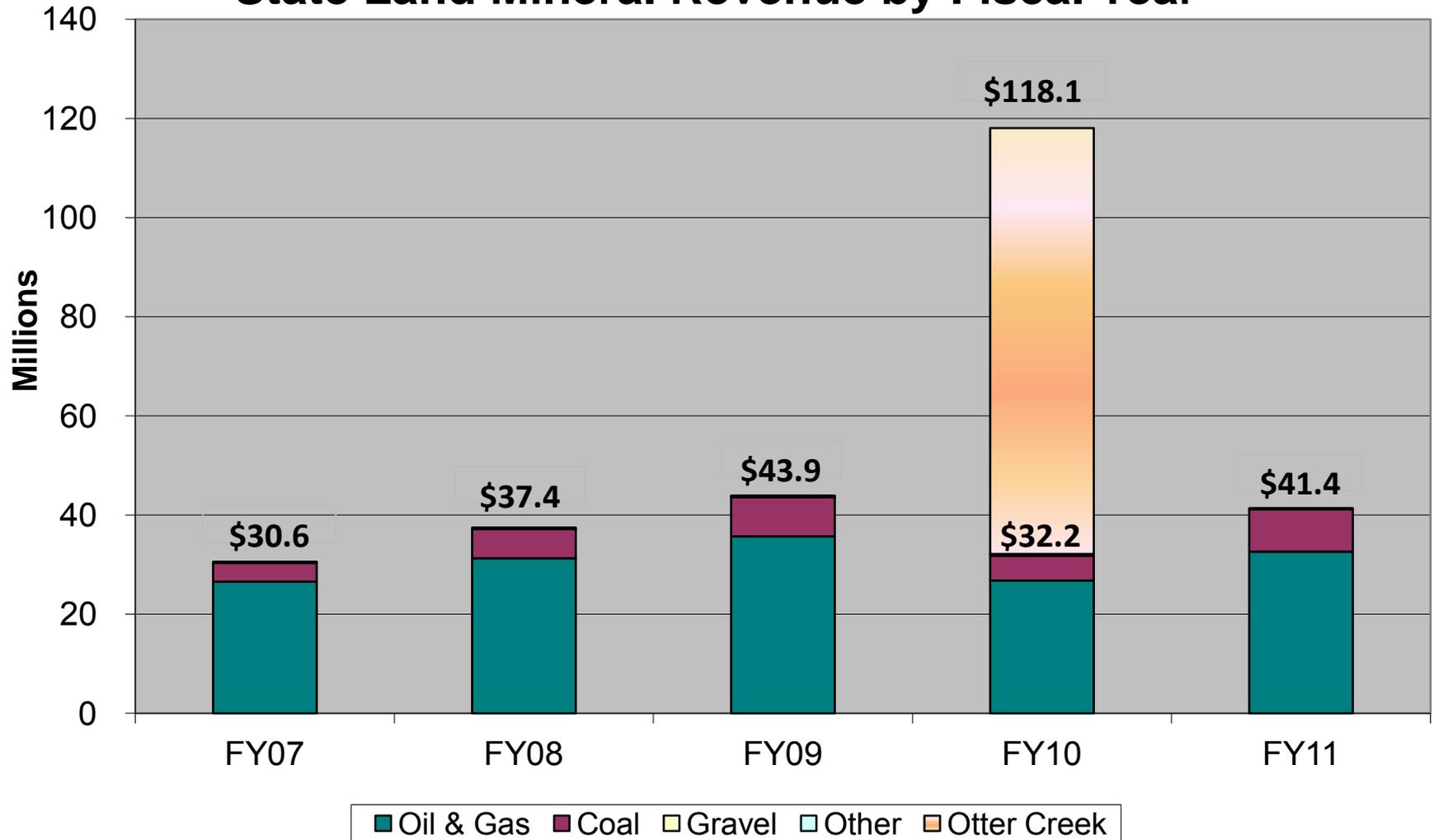
Trust Land Mission

Manage the State of Montana's trust land resources to produce revenues for the trust beneficiaries, while considering environmental factors and protecting future income-generating capacity of the land.

Minerals Management Bureau

- Total revenue from mineral activities in FY2011 generated \$41.4 million, a 28% increase over FY2010 (net of Otter Creek bonus revenue).
- Oil & Gas lease auctions in FY2011 brought in \$13.8 million, a 74% increase over FY2010, and 9% over FY2009. Strong interest continues, with \$11.5 million already generated in the first half of FY2012. Interest ranges from traditional Bakken formation exploration and development in eastern Montana to speculative areas in central and west-central Montana.
- Coal royalty revenue in FY2011 totaled \$8.5 million, a 70% increase over FY2010. (It should be noted that coal royalties do fluctuate from year to year as coal operations move onto and off of state tracts.)
- A district court decision is pending regarding the challenge to the issuance of the Otter Creek leases. Arch Coal continues gathering baseline data and preparing information that will be needed to initiate a MEPA analysis of a mining proposal. Arch Coal and the NCT are also engaged in discussions to draft the operating plans required per the terms of the settlement agreement between the Board and NCT.

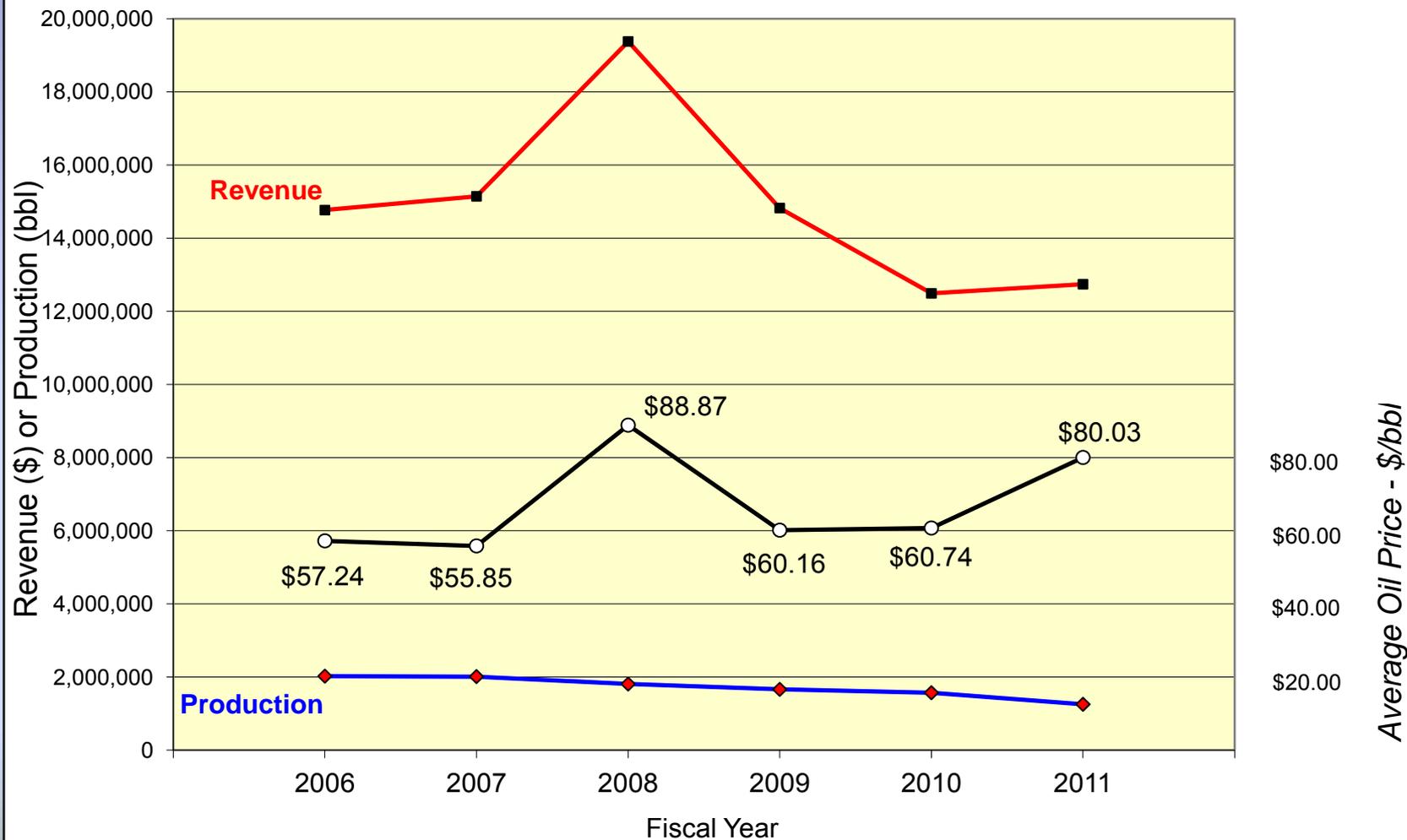
State Land Mineral Revenue by Fiscal Year



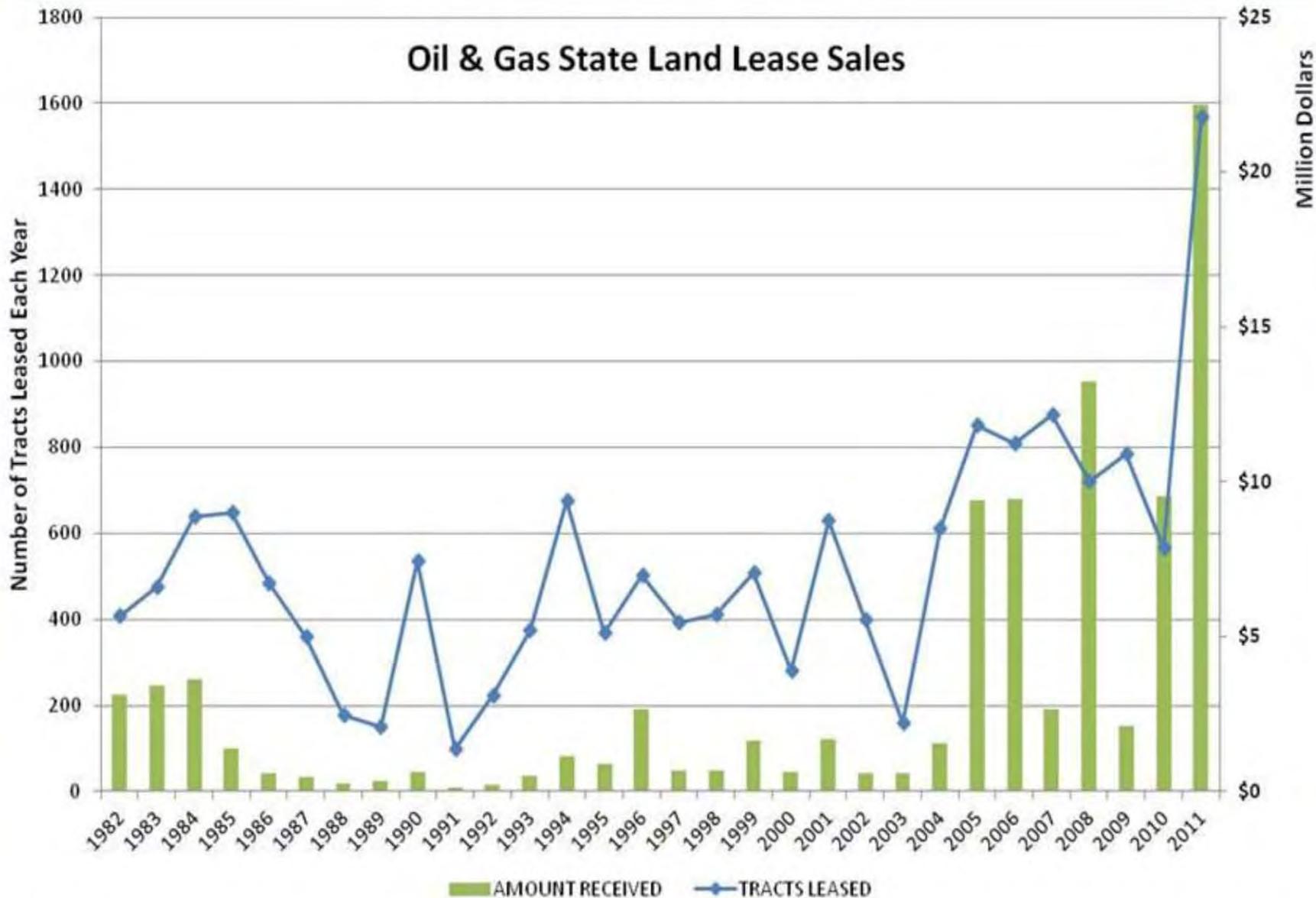
Minerals Management Bureau

RELATED MATERIALS
ATTACHMENT 1

Oil Production, Revenue and Average Price



Oil & Gas State Land Lease Sales

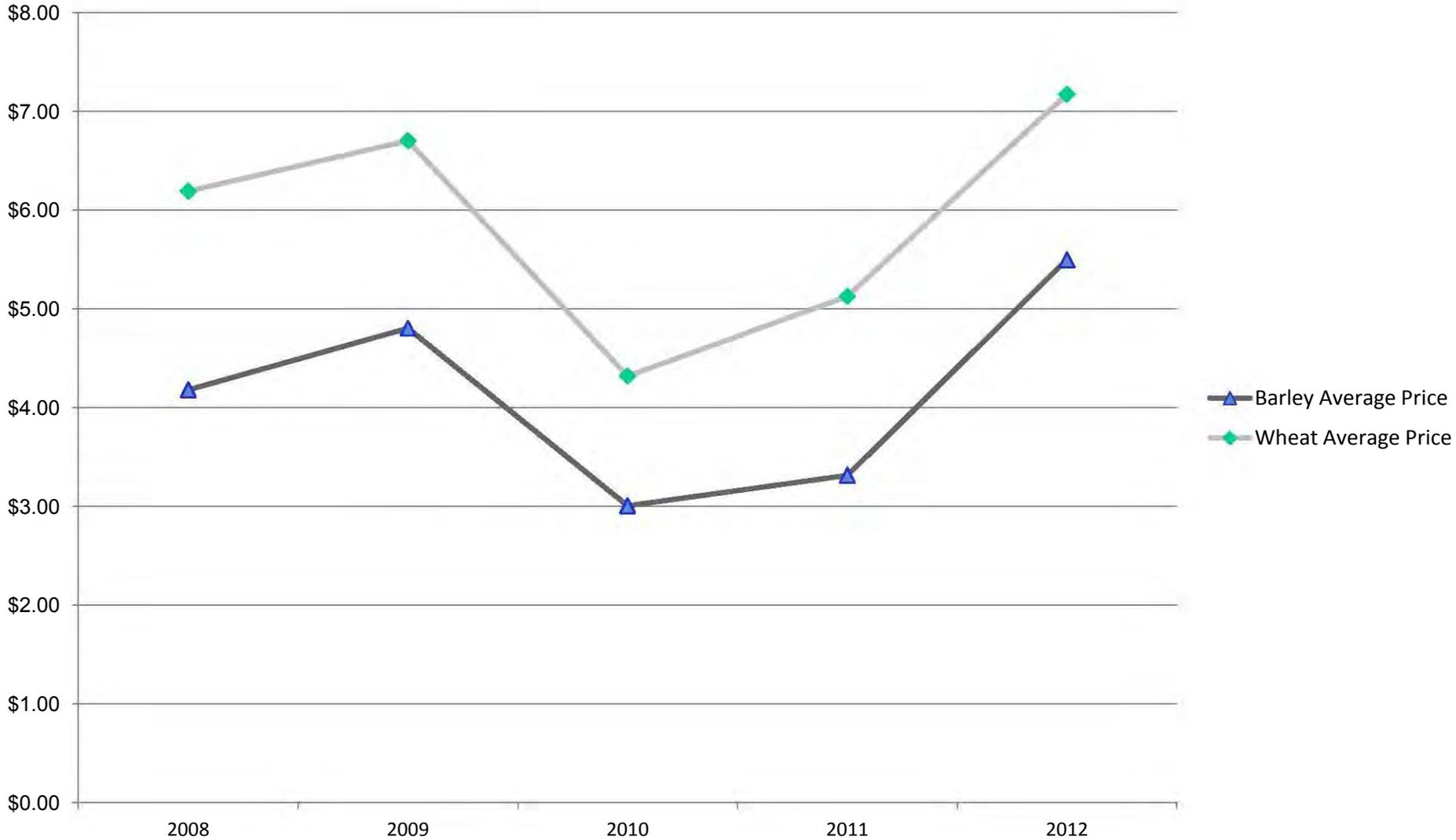


Agriculture & Grazing Management

- Agriculture Revenues \$14.1 million
(\$2.8 million - Farm Program Payments)
- Grazing Revenues \$6.5 million
(975,000 AUMS)
- AUM rate for 2011 - \$6.23/AUM. Minimum grazing rates are calculated annually using Montana beef cattle prices.
- Beginning in 2012, the multiplier used to calculate the grazing rental was increased to 10.48, phased-in over a 5-year period. The 2012 rate is \$7.90 per AUM.

Agriculture & Grazing Management

Wheat & Barley Prices FY 2008 – FY 2012

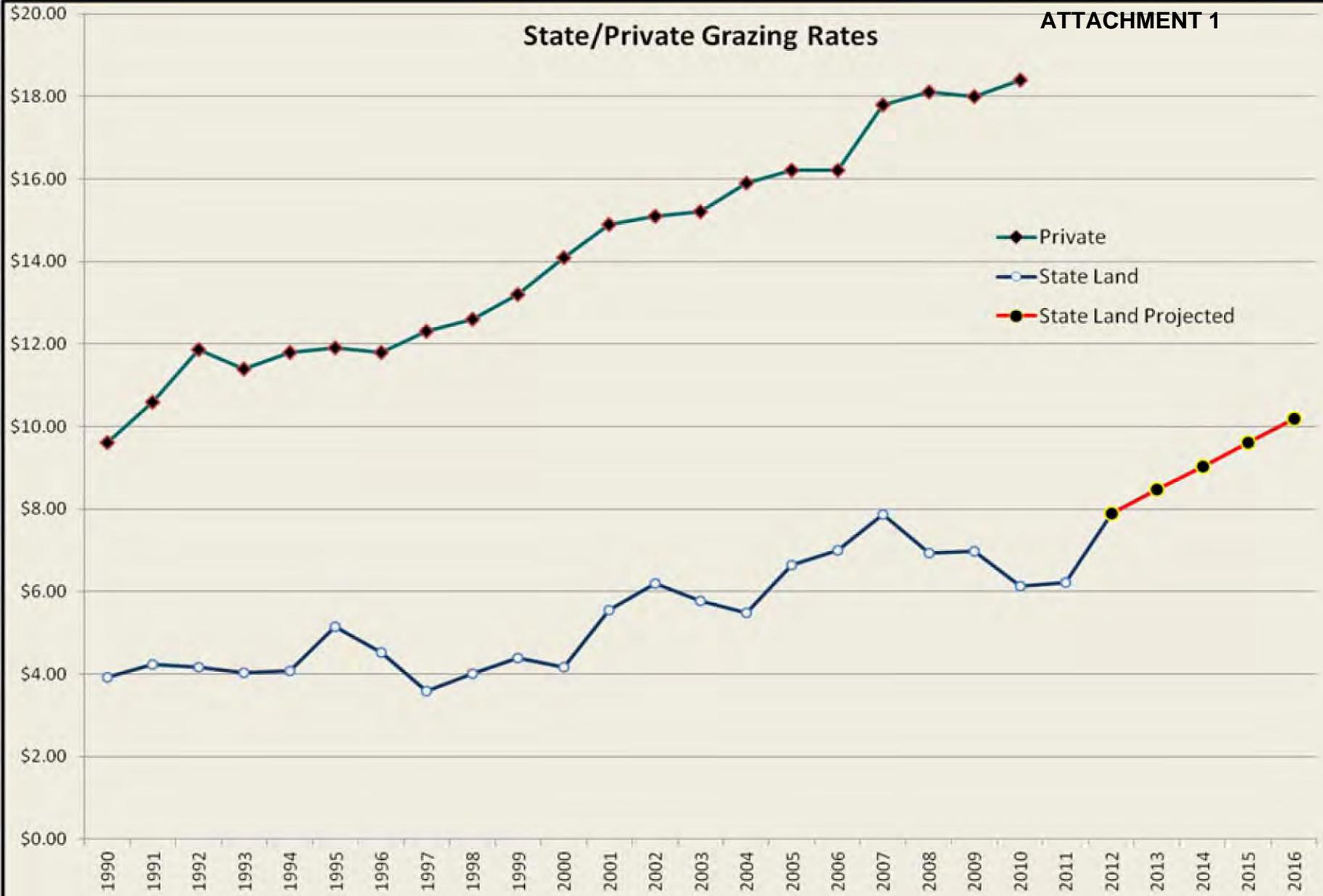


Agriculture & Grazing Management

Montana Beef Cattle Prices CY 2007 – CY 2011



State/Private Grazing Rates

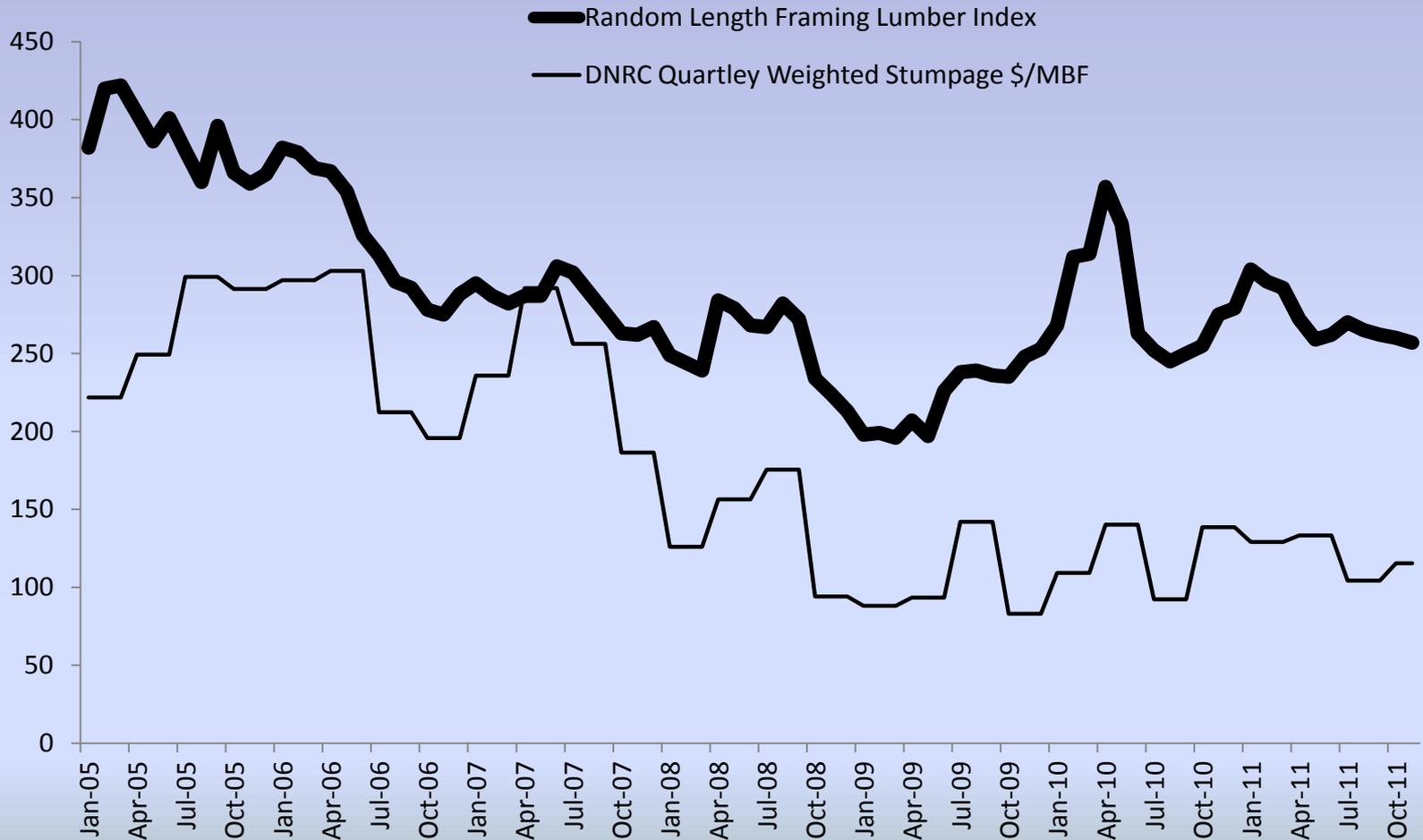


Forest Management Bureau

- Sustainable Forests Supporting Public Education -

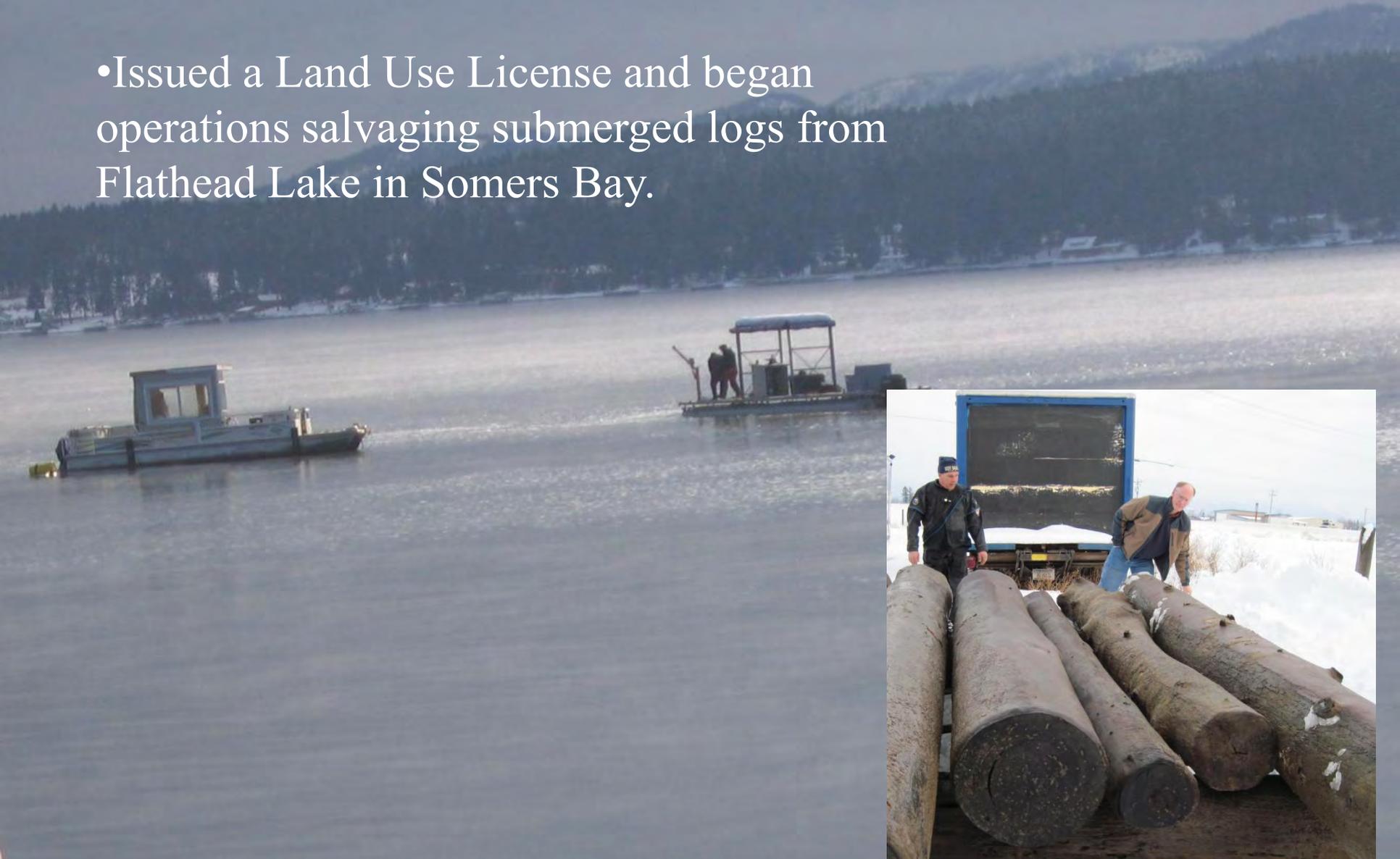
- **Timber volume sold:** 63.7 million board feet – includes 26 timber sales (58.2 MMBF) approved by the Land Board and 40 timber permits (5.5 MMBF).
- **Stumpage Revenue** generated: \$8,615,896
- **Forest Improvement Fees** collected: \$1,880,335
- **Habitat Conservation Plan (HCP):** Record of Decision signed by Director in December 2011.

DNRC Stumpage Prices vs. Random Length Composite Indices



Flathead Lake Logging

- Issued a Land Use License and began operations salvaging submerged logs from Flathead Lake in Somers Bay.



Real Estate Management Bureau

FY 2011 Trust Revenues \$11,355,791

Easements	\$ 566,817
Residential Leases/Licenses	1,816,222
Land Sales	3,111,920
Other Leases/Licenses	
Commercial	1,253,421
Conservation	93,684
Other	81,712
Hydro/Navigable River	<u>4,432,014</u>
Totals	\$11,355,790

Land Banking Sales

<u>Trusts</u>	<u># of Acres</u>	<u>Sales Price</u>	<u>Annual Income</u>	<u>Return</u>
MSU-Morrill	40	\$14,000	\$51	0.36%
Common Schools	5,779	\$2,753,120	\$12,758	0.46%
Public Buildings	440	\$111,400	\$845	0.76%
Univ. of Montana	488	\$233,000	\$2,293	0.98%
Total	6,747	\$3,111,920	\$15,947	Average 0.51%

Land Banking Purchases

<u>Acquisition Name</u>	<u>Trusts</u>	<u># of Acres</u>	<u>Purchase Price</u>	<u>Closing Date</u>
Chamberlain Creek	Common Schools	14,581	\$5,936,150	7/27/2010
North Swan Phase I	Common Schools	1,914	\$1,435,830	12/22/2010

(HB 674) Potomac Purchase

<u># of Acres</u>	<u>Purchase Price</u>	<u>Closing Date</u>
32,210	\$20,915,000	11/17/2010

Land Exchanges

<u>Exchange Name</u>	<u>Acres Exchanged</u>	<u>Acres Received</u>	<u>Value of Land Exchanged</u>	<u>Value of Land Received</u>	<u>Closing Date</u>
Lolo FS	12,137.7	10,530.4	\$18,190,000	\$18,190,000	12/22/2010

Trusts Involved: MSU 2nd, Common Schools, Public Buildings, Eastern/Western

CS&KT PHS I	2412	3,171	\$2,451,400	\$2,460,899	6/16/2010
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Trusts Involved: Common Schools

CS&KT PHS II	2,103.8	2,900.2	\$1,721,100	\$1,740,200	12/30/2011
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Trusts Involved: Common Schools, Public Buildings

Prairie Elk Colony	90	135	\$32,400	\$48,600	11/2/2011
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Trusts Involved: Common Schools

Cabin Sites

3B Rules

Alternative 3B rules were approved by the Land Board in May 2010. A little more than 57% of lessees are now paying a 3B rent. In January 2013 the “E” leases will have completed their 2003 phase-in; at that point roughly 62% of leases will be paying a 3B rent. Then all residential leases will be paying a rent based on either 5% of the 2009 appraised value, or based on Alt. 3B. This assumes no leases are on the SB409 Bidding Method.

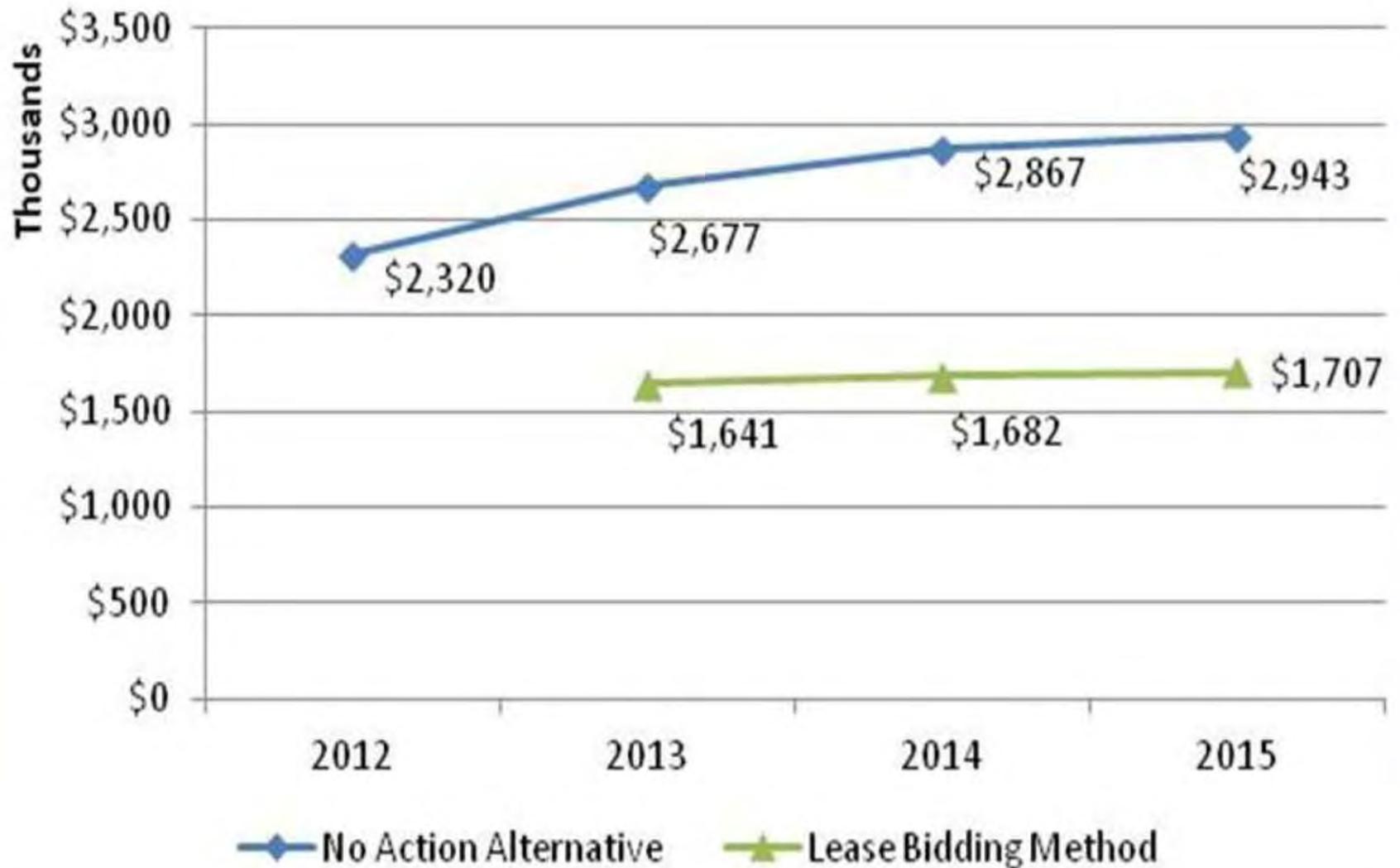
SB409 Rules

The Land Board approved rules for the Senate Bill 409 “Bidding Method” Dec. 19, 2011. Rules will be effective Jan. 13, 2012. Applications for the Bidding Method will first be accepted after Jan. 17, 2012 until Feb 29, 2012.

Vacancy

In fall 2009 DNRC estimated a possible slight increase in lease vacancies with Alt. 3B, but a bigger increase if no changes were made to lease fee calculations. Two years later the overall vacancy rate is within those predictions.

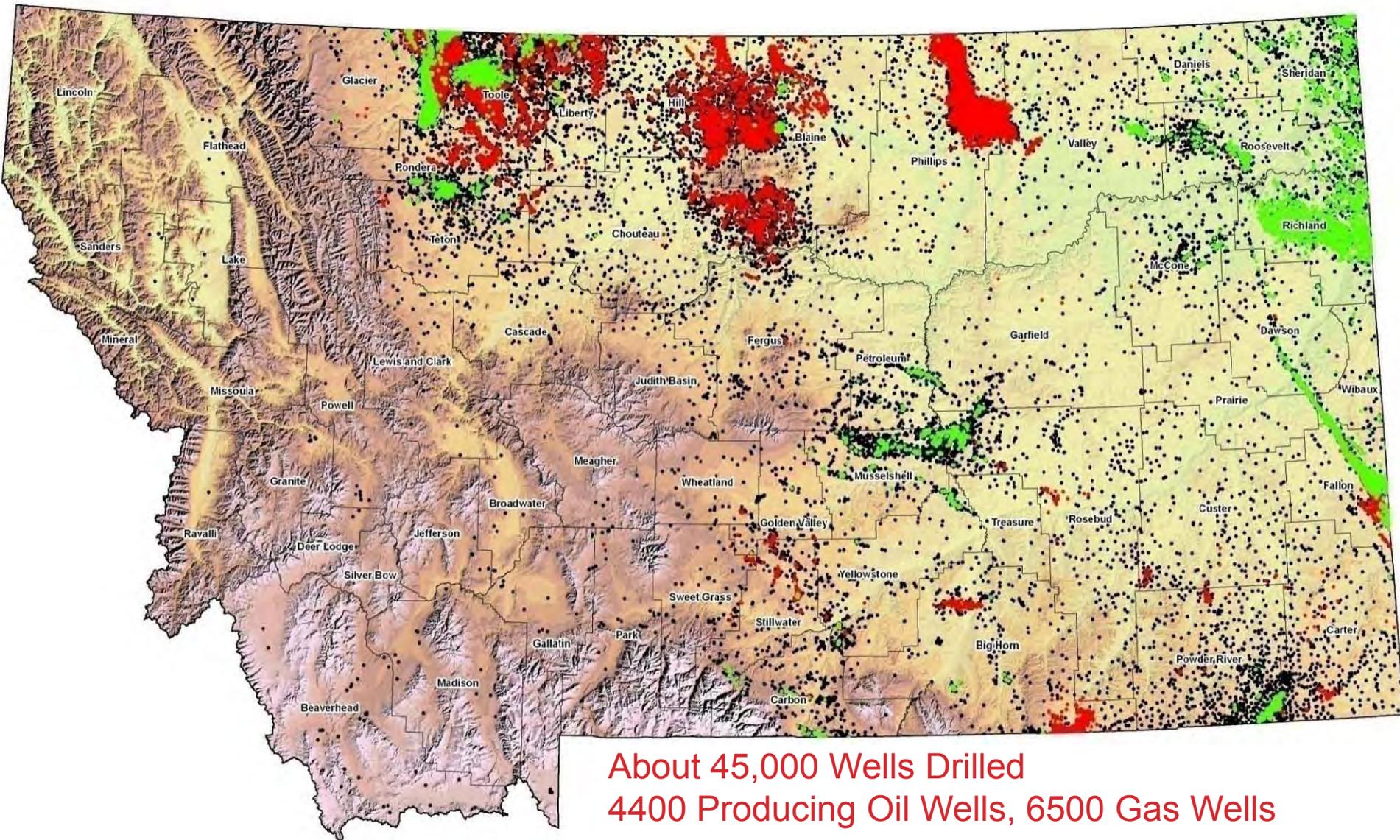
Cabinsites Revenue Projection



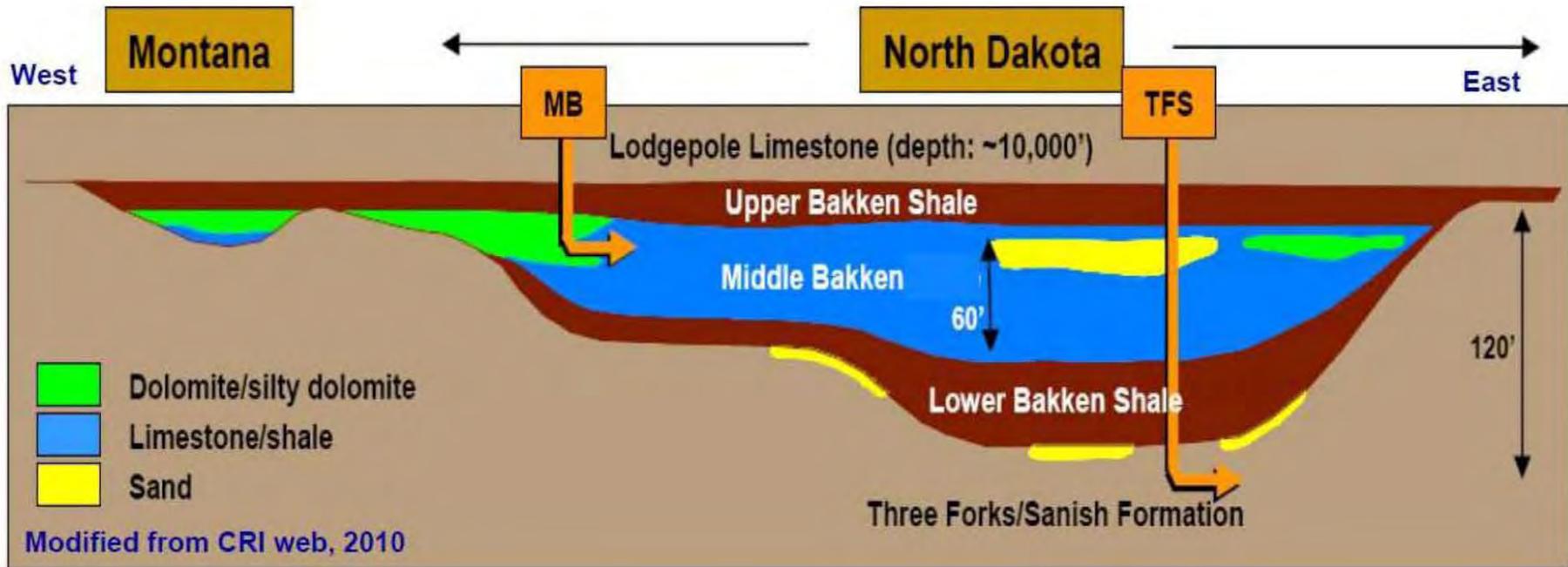
Questions?



Montana Producing Areas and Exploration Activities



Middle Bakken / Three Forks Pay Variation



- **Middle Bakken pay not a shale lithology**
 - Complex, laterally varying lithology & play types
 - Stratigraphic / diagenetic trap drivers
- **Underlying Three Forks 'non-shale' play potential established 2008**
 - Also sourced by Bakken shale
 - Dual zone development underway

from ConocoPhillips

20% lower tax rate in MT on Oil

2010 value of MT oil production~ \$1.8 billion

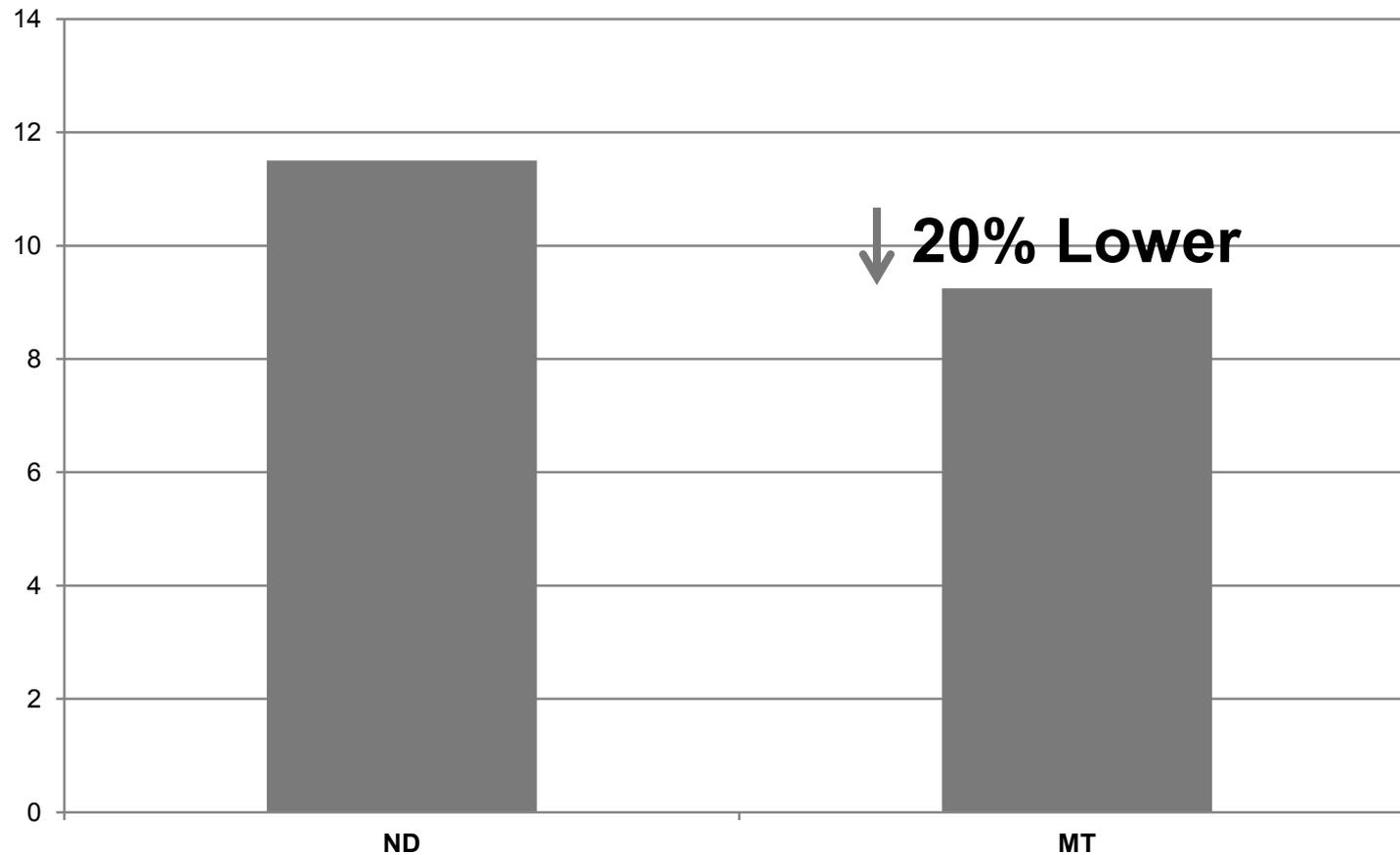
- 9 active drilling rigs, more on the way

Industry agrees MT's business climate and tax structure not detrimental to increased drilling:

- Brigham Energy: "They (Montana) have a good operating environment." (Billings Gazette May, 2011)

**MT = 6th best overall tax climate for business
(Tax Foundation 2011) ND = 20th**

OIL TAX RATE: MT V. ND



PERMITTING COMPARISON

Final Decision Time frames (Statutory and Actual) for Air Quality Permits:

