

**Minutes of the Meeting of the
Board of University and School Lands
October 26, 2017**

The October 26, 2017 meeting of the Board of University and School Lands was called to order at 9:00 AM in the Governor's Conference of the State Capitol by Chairman Doug Burgum.

Members Present:

Doug Burgum	Governor
Alvin A. Jaeger	Secretary of State
Wayne Stenehjem	Attorney General
Kelly Schmidt	State Treasurer
Kirsten Baesler	Superintendent of Public Instruction

Department of Trust Lands Personnel present:

Lance D. Gaebe	Commissioner
Linda Fisher	Deputy Commissioner
Jeff Engleson	Chief Investment Officer
Drew Combs	Minerals Manager
Levi Erdmann	Investment Analyst
Peggy Gudvangen	Accounting Manager
Mike Humann	Surface Manager
Kristie McCusker	Legal Assistant
Catelin Newell	Office Manager
Gerard Schwan	Director of Grants and Claims

Guests in Attendance:

Leslie Bakken Oliver	Governor's Legal Counsel
David Garner	Office of the Attorney General
Hope Hogan	Office of the Attorney General
Ron Rauschenberger	Petrogulf
Chris E. Manning	Slawson Exploration
Lawrence Bender	Fredrikson & Byron
Brady Pelton	North Dakota Petroleum Council
Amy Dalrymple	Bismarck Tribune
Mindy Piatz	Brady Martz (via telephone)

APPROVAL OF MINUTES

A motion to approve both the minutes of the September 28, 2017 meeting and the amended minutes of the August 21, 2017 meeting was made by Secretary of State Al Jaeger and seconded by Attorney General Wayne Stenehjem and the motion carried unanimously on a voice vote.

ENERGY INFRASTRUCTURE AND IMPACT OFFICE

Authorization for Annual Cap of Airport Grants

In August 2017, the Board approved plans to proceed with a grant round for the Dickinson Airport for \$1.5 million and the Williston Airport for \$15 million, for a total of \$16.5 million. The North Dakota Aeronautics Commission, working as the Board's advisory committee, requested consideration to increase the maximum grant consideration for Williston Airport by an additional \$3.5 million.

There are sufficient funds to increase the amount available for airport grants in the current fiscal year:

- 1) \$11 million transferred into the Energy Impact Grant Fund in August 2017; and
- 2) \$2 million deposited in the Energy Impact Grant Fund in September 2017; and
- 3) \$13.9 million deposited in the Oil and Gas Impact Grant Fund for 2017-2019.

Under N.D.C.C. § 15-01-02, only 60% of appropriated grant funds may be expended annually during a biennium. The total of appropriated grant funding in Senate Bill 2013 for the 2017-2019 biennium is \$40 million, thus total grants in either fiscal year cannot exceed \$24 million.

Motion: The Board increases its previous authorization of \$16.5 million of possible grants to airports to \$20 million for the Williston and Dickinson Airports; and the Board directs the Energy Infrastructure and Impact Office to develop grant recommendations in concert with the North Dakota Aeronautics Commission which serves as the Board's advisory committee for this purpose.

Action Record	Motion	Second	Aye	Nay	Absent
Secretary Jaeger		X	X		
Superintendent Baesler			X		
Treasurer Schmidt			X		
Attorney General Stenehjem	X		X		
Governor Burgum			X		

Proposed Criteria for Contingency Grant Round

Section 10 of Senate Bill 2013 of the 65th Legislative Session allowed the use of unexpended funds to provide for grants and administrative costs during the 2017-2019 biennium. In June 2017, the Board approved the establishment of a contingency fund to utilize undistributed funds from previous biennia.

The Board has retired \$2.2 million of remaining balances of previously awarded grants. After grant status reports are collected in December 2017, the Board will have more funds available with the cancelation of unused portions of grants.

The EIIO projects \$400,000 of operations/administrative budget for the biennium.

Unutilized or committed funds in the Oil and Gas Impact Grant Fund:

June 30, 2017 ending balance:	\$2,115,537
Increases in July 2017	+107,069
Anticipated retirements as of January 2018	+500,000
Operations/administrative budget	<u>-400,000</u>
	\$2,322,606

The EIIO recommended grant criteria for the approximate \$2 million contingency of oil and gas impact grant funds as follows:

Funds are available for eligible political subdivisions (e.g., counties, cities, school districts, or other taxing districts) impacted by oil and gas development. Applications must be made by an appointed or elected government official and include a description of an unmet or unanticipated need. Evaluation of applications will be based upon:

- 1) Impact by current oil and gas development activity;
- 2) Shared local cost commitments will score higher and those projects seeking full funding from grants will score lower;
- 3) Applications that address the health, welfare, and safety of the public will score higher. Projects which do not address these factors will score lower;

- 4) Project contribution to sustained economic development or activity;
- 5) Ability to be accomplished within 24 months of the grant award; and
- 6) Provided bids or cost estimates from vendors.

Applications will be accepted until the Board announces the closing of the contingency round, or funds are depleted. The announcement will be posted to the EIO website and distributed to eligible taxing districts through the Western Dakota Energy Association.

The Board took no action but asked the Director to provide recommendations for an advisory committee that could suggest grant criteria and timelines.

MINERALS MANAGEMENT

Sovereign Lands’ Submerged Minerals

On September 28, 2017, the North Dakota Supreme Court reversed the district court’s decision and remanded *Wilkinson v. Board of University and School Lands*, back to the district court.

The Supreme Court held that:

- 1. Surface ownership could not be determined without the United States as a party to the action.
- 2. N.D.C.C. ch. 61-33.1 applied retroactively and the district court did not have an opportunity to determine if it applies and governs ownership of the minerals at issue;
- 3. A “takings” analysis must be conducted if the district court determines the State owns the disputed minerals; and
- 4. The district court erroneously made findings of disputed fact.

EXECUTIVE SESSION

Motion: **Under the authority of North Dakota Century Code Sections 44-04-19.1 and 44-04-19.2, the Board close the meeting to the public and go into executive session for purposes of attorney consultation to consult with the Board’s attorneys relating to: provide guidance to legal counsel on *Wilkinson v. Board of University and School Lands*; and other pending or anticipated litigation concerning sovereign lands’ submerged minerals.**

Action Record	Motion	Second	Aye	Nay	Absent
Secretary Jaeger	X		X		
Superintendent Baesler			X		
Treasurer Schmidt			X		
Attorney General Stenehjem		X	X		
Governor Burgum			X		

At 9:27 AM the Board entered executive session for the purposes outlined in its adopted motion.

EXECUTIVE SESSION

Members Present:

- | | |
|-----------------|--------------------------------------|
| Doug Burgum | Governor |
| Alvin A. Jaeger | Secretary of State |
| Wayne Stenehjem | Attorney General |
| Kelly Schmidt | State Treasurer |
| Kirsten Baesler | Superintendent of Public Instruction |

Department of Trust Lands Personnel present:

Lance D. Gaebe	Commissioner
Linda Fisher	Deputy Commissioner
Drew Combs	Minerals Division Manager
Catelin Newell	Office Manager
Gerard Schwan	Director of Grants and Claims

Authorized Guests in Attendance:

Hope Hogan	Office of the Attorney General
David Garner	Office of the Attorney General
Leslie Bakken Oliver	Governor's Legal Counsel

The executive session adjourned at 9:41 AM and the Board returned to open session and the public was invited to return to the meeting. During the executive session, the Board provided its attorneys with guidance on *Wilkinson v. Board of University and School Lands*.

Oil and Gas Lease Extension Request Mountrail County 152-92-36: S2 & 151-91-6: SE4, E2SW4, Lots 6,7

On February 7, 2012, the Board issued two leases to Slawson Exploration Company, Inc. ("Slawson"), covering the Common Schools Trust Fund tracts' mineral interests in the SE/4 and SW/4 of Section 36, Township 152 North, Range 92 West. In addition, Davis Exploration LLC ("Davis") has Department issued leases of tracts held by the Strategic Investment and Improvements Fund (SIIF) in Section 6: SE4, E2SW4, Lots 6 and 7, Township 151 North, Range 91 West (collectively referred to as "the Leases"). The Leases are within a unit operated by Slawson for the Torpedo Unit, a five-section unit comprised of 3,106.02 acres. The Leases cover a total of 312.11 net mineral acres and were issued for a bonus payment of \$1,565,504.

On July 27, 2011, Slawson submitted six applications for permits to drill ("APDs") to the Bureau of Land Management (BLM). On May 8, 2015, Slawson submitted four more APDs to the BLM. The primary terms of the Leases expired on February 6, 2017. The BLM issued eight permits to Slawson on May 9, 2017.

Slawson notified the Department in November of 2016, indicating it was experiencing an abnormal delay in getting federal approvals for its location and drilling program. An update letter from Slawson was received January 10, 2017 on the described activities. At that time Slawson's out-of-pocket expenses on pad construction was \$475,000.

Based upon drilling activity, the Commissioner issued two six-month lease extensions, extending the primary term of the Leases from February 7, 2017 to January 31, 2018.

Slawson believes the most efficient and safest method of developing the minerals is to drill at least eight wells at once, rather than drilling only one well in order to obtain initial production to hold the Leases. The project currently has three wells drilled and uncompleted, which will be hydraulically fractured and completed later. After completion of the initial six, two additional wells are planned to be spud.

Slawson applied to add an additional two wells to the location, bringing the total number of wells to ten. However, the BLM has not yet approved the additional wells. Slawson has expended \$15,350,000 on the project, not including the cost of leases.

Based on its continuing drilling operations, Slawson requested an additional one-year extension, from February 1, 2018 through January 31, 2019, because it plans to complete the batch drill of at least eight wells. Slawson believes that without further federal delays, production can be obtained by late 2018.

It was recommended that the Board approve a one-year extension of the Leases subject to evidence of continuous drilling operations leading to production of oil and gas. The proposed fee for this was \$30 for the third extension and \$40 for the fourth extension.

Motion: The Board authorizes a one-year extension of the Leases located in Mountrail County Township 152 North, Range 92 West Section 36: S2 and Township 151 North, Range 91 West Section 6:SW4, E2SW4, Lots 6 & 7 from February 1, 2018 through January 31, 2019 as long as Slawson is conducting good faith drilling, testing, and completion operations as required under Section 8 of the Leases and Slawson provides monthly reports detailing its drilling operations to evidence its compliance with the terms of the Leases and pays a fee of \$70.00 per net mineral acre.

Action Record	Motion	Second	Aye	Nay	Absent
Secretary Jaeger			X		
Superintendent Baesler			X		
Treasurer Schmidt		X	X		
Attorney General Stenehjem	X		X		
Governor Burgum			X		

I N V E S T M E N T M A N A G E M E N T

Investment Policy Statement Review and Update

Proposed changes to the Board's Investment Policy Statement (IPS) were reviewed. The proposed changes reflect the new asset allocation adopted for the permanent trusts in August 2017, an updated broad international equity benchmark, other updates intended to clarify distribution calculations, corrected references to the North Dakota Century Code, as well as changes because of 2017 legislation. There were also minor changes to formatting, grammar, and clarification of legal references recommended.

Motion: The Board approves the amended Investment Policy Statement as presented.

Action Record	Motion	Second	Aye	Nay	Absent
Secretary Jaeger	X		X		
Superintendent Baesler			X		
Treasurer Schmidt			X		
Attorney General Stenehjem		X	X		
Governor Burgum			X		

The amended Investment Policy Statement is available at the Department.

Search for International Small Cap Equity Manager

Previously, the Board approved a new benchmark for the permanent trusts' international equity portfolio; adopted an allocation to actively managed international small cap equities; and directed the Commissioner to work with RVK to conduct a search for a new active small cap international equity manager and to provide a recommendation of a candidate(s) for Board consideration.

The Department and RVK reported the search included a review of 149 international small cap products found in the eVestment Alliance database. Criteria used to perform an initial screen of the investment managers within the database were summarized for the Board:

Screening Criteria	Failing	Rationale for Criteria
Strategy Listed as Closed to New Investments	16	International small cap is a capacity constrained asset class, those strategies listed as closed should not be accepting new mandates.
No Five-Year Track Record	43	Generally when evaluating managers, the more data the better. In this asset class, requiring a 5 year track record strikes a balance between wanting to hire established managers and needing to review newer strategies with ample capacity.
Firm AUM < \$5 billion	29	Total firm AUM can serve as a proxy for firm stability. \$5 billion is a level that allows a firm to adequately staff and support an international investment team (including back office and trading), without eliminating qualified boutique managers.
Portfolio Manager (PM) Turnover > 50% and remaining PM < 20 yrs industry experience	9	PM turnover is not considered good, however, if the new PM(s) have 20 or more years of industry experience it was decided that those firms could continue to be included in the search.
Product AUM < \$300 million	69	Given the difficulty involved in trading international small cap equities, a minimum level of AUM provides comfort that the firm should be able to execute their trading strategy at an institutional level of assets.
3 Year Performance Consistency > Median	64	Consistency of performance is important. This sort eliminates those products that, on average, do not outperform peers over rolling three year time periods.
Calendar Year Returns > Median of the Peers in the Database	70	This screen uses consistency of calendar year returns to further screen out managers that do not outperform their peers on a regular basis.

Ten firms which met the applied criteria received Requests for Information (RFI) questionnaires. Additionally, three non-US small cap managers used by the State Investment Board (SIB) were included in the RFI due to the potential for fee savings.

Investing internationally via a commingled fund or mutual fund product reduces the amount of administrative time spent on tax, exchange, and custody issues and costs. Investing via a fund is believed to be the most cost effective way for the trusts to gain exposure to international markets. A number of the entities that responded did not have a commingled or mutual fund in which the trusts could invest.

Of the 13 investment firms that were asked to submit an RFI, eleven responded. The responses detailed: ownership structure, professional staff, investment philosophy/process, risk management, performance and fees. In coordination with RVK, applications were scored. Rankings, responses and fees were compared resulting in the selection of four candidates to further review:

- Barrings LLC, Charlotte, NC
- Quantitative Management Associates LLC, Newark, NJ
- Schroder Investment Management Ltd., London, England
- T. Rowe Price Group, Inc. Baltimore MD

Interviews will be arranged with these managers, with the objective to provide a recommendation to the Board to consider to manage a small cap international portfolio for the permanent trusts.

Investment Updates

Lazard (US High Yield Fixed Income: \$126.0 million, 3.0% of assets)

Partly in response to the retirement of lead portfolio manager Tom Dzwil, the Department's investment analyst Levi Erdmann and Marcia Beard from RVK visited the Lazard Asset Management offices in New York to review the Board's high yield portfolio. The meeting did not uncover any immediate concerns, however the role of this manager will continue to be reviewed as part of a more detailed analysis of the broad fixed income portfolio.

S U R F A C E M A N A G E M E N T

Proposed Burke Wind, LLC Wind Farm (Burke County: 36-161-91 and 16-161-92)

NextEra Energy Resources LLC (NextEra), applied for a Wind Energy Easement Agreement (easement) for its Burke Wind LLC, to place eight wind towers within section 36-161-91 and section 16-161-92 Burke County. The proposed Burke Wind Energy Center will contain approximately 82 wind towers and produce 200 megawatts of power.

The Department conducted an onsite inspection of the trust property, including the eight proposed wind tower locations, associated access road, collection lines and construction crane access paths. Wind tower locations were positioned in coordination with the Department to maximize the number of wind towers and minimize environmental interference on trust land.

When NextEra has secured agreements with a majority of the landowners within the project area, an application will be presented to Burke County Planning and Zoning Commission and the Burke County Commissioners for approval. Upon local approval, NextEra will submit an application to the Public Service Commission (PSC) for project approval.

NextEra has asked for confirmation that the Board will consider an easement for the Burke Wind Energy Center should the wind energy center be approved by Burke County and the PSC. If Burke County and the PSC approve the project, the Department would negotiate proposed easement terms with NextEra and present a draft easement agreement to the Board for its consideration.

Motion: The Commissioner is authorized to confirm by letter that the Board will consider a Wind Energy Easement Agreement with Burke Wind LLC regarding the location and potential use of trust land within the Burke Wind Farm; and upon Burke County and the Public Service Commission's approval of the project, the Commissioner is authorized to negotiate and submit a recommended easement and terms for Board consideration.

Action Record	Motion	Second	Aye	Nay	Absent
Secretary Jaeger	X		X		
Superintendent Baesler			X		
Treasurer Schmidt			X		
Attorney General Stenehjem		X	X		
Governor Burgum			X		

O P E R A T I O N S

Audited Financial Statements for the Year Ended June 30, 2017

Brady Martz Certified Public Accountants and Consultants completed its review of the financial statements of the Department of Trust Lands for the year ended June 30, 2017 and provided an opinion on the fair presentation of the financial statements. Mindy Piatz of Brady Martz reviewed the report with the Board.

The report identified no audit findings or recommendations.

The audited financial statement is available on the State Auditor's and the Department of Trust Lands' websites.

Common Schools Trust Fund Revenue and Distribution History

Educational and institutional trust distributions are based upon the growth in value of the trusts' financial assets over time. The Board reviewed the historical annual distributions from the Common Schools Trust Fund and the amount of income and assets available to make those distributions.

- **Statehood through FY 2009:** In most years up to 2009 “interest and income” including investment income and dividends, surface rentals and mineral rentals was distributed to the common schools. Revenues from minerals royalties and bonuses, easements, unclaimed property, etc., was deposited into the corpus, and could not be distributed.

The exception was during 1980 through 1984 when a portion of the collected mineral lease bonuses were distributed. A constitutional measure was adopted that ceased the spending of bonuses. The distributions including bonuses generated high payout rates in Fiscal Years 1980 through 1984.

- **FY 2010 to present:** Starting in Fiscal Year 2010 distributions are based on the growth in value of the trust fund over time as determined under the formula found in Article IX, Sec. 2 of the State Constitution. Revenues from all sources are deposited into the fund and the total financial value determines distributions.

Biennial distributions must be ten percent of the five-year average value of trust assets, excluding the value of lands and minerals. Equal amounts are distributed during each year of the biennium.

Oil and gas lease bonus and royalty revenues resulted in substantial growth in the Common Schools Trust Fund which increased by 300% over eight years. Strong investment markets have also been a big driver of growth since the 2008-2009 recession. Because the distribution formula is based on assets values over a previous five years, and the trust is experiencing substantial trust growth, the effective distribution rate has averaged 3% over past eight years. The growth in trust assets results in trust distributions growing by 331% from 2008-2009 biennium to the 2017-2019 biennium.

Performance Audit Status Update

The State Auditor’s performance audit report No. 3036 relating to the Energy Infrastructure and Impact Office, Unclaimed Property, and Trust Assets and Department Resources was published in April 2016. The Board reviewed a summary of progress on the various accumulated recommendations.

One issue identified during the performance audit involved improper Trust assignments to mineral parcels involving the Youth Correctional Center and the Ellendale Trust. Extensive efforts to review historical information to validate trust mineral ownership has been underway. This project involves retrieving documents from historical archives and comparing paper records to electronic data.

County record reviews will continue to be prioritized using oil and gas production statistics, followed by counties with coal production, and then counties with little or no anticipated current or historical financial impact. Nearly 700 hours of staff time has been expended in this effort. Additional errors have been identified; however, overall the impact of the discovery has been far less than what was encountered with the Youth Correctional Center and the Ellendale Trusts mis-assignment.

OTHER BUSINESS

Commissioner Hiring Process

Governor Burgum indicated that background checks are being performed on four applicants. Once background checks are complete, the finalists will be presented to the Board for interviews in a special meeting.

R E P O R T S

Summary of Investment Fees Paid in FY 2017

The report of investment fees and expenses paid during the fiscal year ended June 30, 2017 was reviewed by the Board.

The pooled investments of the permanent trusts had an average market value of \$3.91 billion and paid \$20,993,639 during the fiscal year, resulting in an average fee rate of 0.537% of the average assets. Net of fees, the permanent trust pool realized a total return of 9.65% in fiscal year 2017.

The pooled investments of the Coal Development Trust Fund, the Strategic Investment and Improvements Fund (SIIF), and the Capitol Building Fund had an average market value of \$335.3 million during the fiscal year and paid \$214,894 in investment management fees, an average fee rate of .064%. The SIIF/Coal/Capitol investment pool had a total return of 1.01% net of fees for the fiscal year.

Securities Lending Annual Report

A report describing the performance and status of the Board's securities lending program, as facilitated by Northern Trust, for the fiscal year ended June 30, 2017, was reviewed by the Board.

The Board's investment policy specifies that securities lending should utilize a high-quality and conservative collateral re-investment approach that safeguards the return of principal and maintains adequate daily liquidity to support trade settlement activity and portfolio restructuring activities.

Report of Easements Issued by Land Commissioner 09/12/2017 to 10/16/2017

Granted to:	ROCKWATER ENERGY SOLUTIONS, DICKINSON-ND
For the Purpose of:	Letter of Permission: Access to School Land for a temporary above ground frac water pipeline
Right-of-Way Number:	RW0008127
Trust:	A - Common Schools
Legal Description:	MCK-150-96-36-SE4
Granted to:	STANG FARMS, REGENT-ND
For the Purpose of:	Easement: Potable Water Pipeline
Right-of-Way Number:	RW0008115
Trust:	A - Common Schools
Legal Description:	HET-135-97-28-NE4
Granted to:	WPX ENERGY WILLISTON LLC, KILLDEER-ND
For the Purpose of:	Letter of Permission: Access to School Land for a temporary above ground frac water pipeline
Right-of-Way Number:	RW0008120
Trust:	A - Common Schools
Legal Description:	MOU-150-92-10-S2SW4
Granted to:	PETRO-HUNT LLC, BISMARCK-ND
For the Purpose of:	Easement: Raw Water Pipeline
Right-of-Way Number:	RW0008048
Trust:	A - Common Schools
Legal Description:	WIL-154-99-16-NE4, NW4, SW4
Granted to:	MEDORA GRAZING ASSOCIATION, MEDORA-ND
For the Purpose of:	Easement: Raw Water Pipeline
Right-of-Way Number:	RW0008131
Trust:	A - Common Schools
Legal Description:	BIL-138-101-36-SE4

Granted to: **CANTICLE PRODUCTIONS LLC, BISMARCK-ND**
For the Purpose of: Letter of Permission: Access to School Land or access for production filming purposes
Right-of-Way Number: RW0008139
Trust: A - Common Schools
Legal Description: SLO-136-102-16-NE4, SE4, SE4NW4, LOTS 1,2,3, SW4

Granted to: **UNIVERSITY OF NORTH DAKOTA, GRAND FORKS-ND**
For the Purpose of: Permit: To conduct sampling of a coal outcrop
Right-of-Way Number: RW0008125
Trust: A - Common Schools
Legal Description: SLO-136-102-16-NE4

Granted to: **ROCKWATER ENERGY SOLUTIONS, DICKINSON-ND**
For the Purpose of: Letter of Permission: Access to School Land for a temporary above ground frac water pipeline
Right-of-Way Number: RW0008135
Trust: A - Common Schools
Legal Description: DUN-147-96-36-NE4, E2SE4

Granted to: **WEST DAKOTA WATER LLC, WILLISTON-ND**
For the Purpose of: Letter of Permission: Access to School Land for a temporary above ground frac water pipeline
Right-of-Way Number: RW0008130
Trust: A - Common Schools
Legal Description: MCK-150-97-36-SE4, SW4

Granted to: **CONSOLIDATED TELCOM, DICKINSON-ND**
For the Purpose of: Easement: Communication Cable - Buried
Right-of-Way Number: RW0008143
Trust: H - State Hospital
Legal Description: BOW-132-106-30-E2NW4, LOTS 1,2

Granted to: **GOODNIGHT MIDSTREAM BAKKEN LLC, DALLAS-TX**
For the Purpose of: Easement: Salt Water Pipeline
Right-of-Way Number: RW0008111
Trust: A - Common Schools
Legal Description: MCK-149-96-16-NE4, NW4

Granted to: **SELECT ENERGY SERVICES LLC, WILLISTON-ND**
For the Purpose of: Letter of Permission: Access to School Land for a temporary above ground frac water pipeline
Right-of-Way Number: RW0008145
Trust: A - Common Schools
Legal Description: MCK-149-95-36-LOTS 3,4

A D J O U R N

There being no further business, the meeting was adjourned at 10:51 AM.

Doug Burgum, Chairman
Board of University and School Lands

Linda Fisher, Secretary
Board of University and School Lands

(10/26/17)