Trust Land Performance Assessment

Maximizing Opportunities

Legislative Update

Prepared by
Washington State Department of Natural Resources

Office of the Commissioner of Public Lands, Hilary Franz
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Executive Summary

The Department of Natural Resources (DNR) State Lands program is leading an asset and business management assessment (together, Trust Land Performance Assessment) associated with managing the state trust lands portfolio. This work is a Commissioner of Public Lands priority as identified in the forthcoming strategic plan for the DNR. This work is funded and directed by the Legislature in a 2018 capital budget proviso (ESSB 6095.PL, Appendix A).

DNR values the opportunity to complete this analysis and to develop recommendations for further enhancement of the trust portfolio. Similar reviews (1996 Deloitte and Touche Review, 2004 Evaluation of Effectiveness and Efficiency, 2006 Commercial Lands Program review) over the years have provided great benefit to DNR by identifying opportunities and challenges to create actionable recommendations toward improving the reliability and maximization of trust revenue through sustainable land management.

The trust portfolio is diverse in both land and revenue source. At more than three million acres, the portfolio extends from sustainable forest products (~2.1 million acres), commercial property leasing (39 properties), communication sites (~380 leases), irrigated agriculture (~50,000 acres), wheat and grains (~136,000 acres), grazing and range land (~800,000 acres), and green energy development (solar and wind). These assets hold tremendous value, providing intergenerational trust revenue, ecosystem services, sustaining jobs, and supplying sustainable food and timber for the state, region, and world.

The recommendations from the Trust Land Performance Assessment will help guide DNR for many years to come. We are continuously assessing and reassessing the performance of our programs and this undertaking will further enhance those efforts. We look forward to working with the Legislature on a commercial lands funding request that will assist in program improvements to increase near term monetary returns for the trusts while we continue this forward-looking assessment.

Thank you for your attention to this important work.

*Data, facts, figures, and maps are sourced from DNR unless noted otherwise. DNR uses the utmost care in assembling information from the most updated sources. The complexity of the data may create rounding or other differences in comparison to other reports or planning documents.
Trust Land Performance Assessment Project

Introduction

The Commissioner of Public Land and State Lands program is leading the Trust Land Performance Assessment associated with managing the trust portfolio. This work is funded by the Legislature in a 2018 capital budget proviso (ESSB 6095.PL, Appendix A) that provides substantive and timeline expectations for DNR. State Lands, beneficiaries, stakeholders, and legislators have a high level of interest in the outcomes of this review.

In This Report

This report focuses on the project objectives, deliverables, and updates. The majority of the work to meet the goals of the proviso and DNR will occur in calendar year 2019. The most substantial element of this work will be contracting to complete an asset valuation and identification of new opportunities to maximize trust revenues. The Request for Proposal (RFP) is currently open at the time of this report with the goal of selecting a qualified contractor by the beginning of 2019.

Vision

Optimize DNR trust asset management such that the corpus of the trusts are maintained or increase, and that revenue to trust beneficiaries grows consistent with a robust return on investment.

Part of DNR’s duty is to provide the highest value to trust beneficiaries and manage state trust lands sustainably. As part of this commitment, DNR’s State Lands is conducting the Trust Land Performance Assessment.

Goal

Continuously improve the revenue performance of trust assets through forward-looking planning, identification of future opportunities and challenges, state-of-the-art business practices, and clear communication with trust beneficiaries, the Legislature, and stakeholders.

As part of this project, DNR will develop the information necessary to make informed choices regarding near and long-term investments. DNR also will explore potential new business lines across a variety of applications and programs.
Progress to Date

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<tr>
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<tbody>
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<td>Project Outreach Plan</td>
<td>August 2018</td>
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<td>October 2018</td>
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<td>Initial outreach with 50 stakeholder groups</td>
<td>October 2018</td>
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<td>September 2018</td>
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<td>November 2018</td>
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<td>November 2018</td>
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<td>Legislative Report- progress report</td>
<td>December 2018</td>
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</tbody>
</table>

See Timeline and Deliverables for future milestones

Principal  Contacts for DNR

**Project Manager**, David Bergvall, Senior Policy and Project Manager, 360.902.2123, david.bergvall@dnr.wa.gov

**Policy and Legislation**, Joanna Eide, Legislative Director, 360.902.1424, joanna.eide@dnr.wa.gov

**Deputy Supervisor for State Uplands**, Angus Brodie, 360.902.1355, angus.brodie@dnr.wa.gov
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<td>Contractor working on valuation and performance assessment</td>
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<td>Develop data requirements, assemble data packages; GIS, expenditures</td>
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<td>Researching new revenue-generating opportunities</td>
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<td>Stakeholders’ initial brainstorming on the project</td>
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- Complete
- Not started
- Active
Structure and Methods

Project Structure

The project is well-supported and uses established project management structures within DNR. A single project manager coordinates the project elements and is ultimately responsible for delivering the project deliverables on time and on budget. The Advisory Group (executive management) provides project and policy oversight and creates accountability for timelines and deadlines. The Technical Group (chief economist, chief appraiser, contracts managers, budget manager, data analyst) provide technical review and project planning. The Technical Group ensure that the project conforms to standards of business, contracting, and appraisals.
Contracting for Services and Request for Proposals
The proviso provides funding and authorizing language for contracts to assist with the project. DNR welcomes the assistance of outside resources to complete the assessment. A Request for Proposals (RFP) for a contractor to assist with the assessment was released in October, 2018. The contractor procurement process will be completed near the beginning of 2019.

Deliverables

DNR has developed several key deliverables for the project; chief among these are comprehensive documentation and planning. At the time of this report, some of the deliverables have been completed, while others will develop as the project matures.

Deliverable 1: Project Scoping and Project Structure in Place
One of the first steps to ensure success is an approved project plan that identifies the elements of the project, structure, risks, and resources needs. For this project, a hybrid of project management methods (traditional, waterfall, agile) will be implemented. Identifying decision-makers, project responsibilities, and advisory roles is critical to ensure timely delivery of the project while leveraging the best individual and group thinking DNR and stakeholders have to offer.

Deliverable 2: Project Outreach
The outcomes of this project are of great importance to many parties. Due to this and the nature of the project and beneficiaries, DNR identified the need to invest in stable and ongoing communication to a variety of interested parties and legislative staff. Communicating the project plan, process, content, and outcomes will be critical to project success.

Deliverable 3: Contracting Resources
The authorizing provisio allows the use of contracted services to complete the valuation assessments and final reports. In 1996, Deloitte & Touche LLP completed a similar report that dove deep into DNR’s data and practices. We anticipate that this project will produce a similar type of report using modern analytical methods for valuations, including but not limited to, passive non-market, ecosystems services, and marketing forecasting.

Deliverable 4: Business Opportunity Research
The budget proviso directs DNR to identify opportunities to increase and stabilize revenue streams for the beneficiaries. In order to research and explore new avenues for growth, DNR intends to: (1) interview private and public asset managers in the continental United States and adjacent countries, (2) host brainstorming efforts with internal staff and external stakeholders
for the purposes of identifying new business pathways, and, (3) where possible, review literature to build concepts and document methods.

**Deliverable 5: Reporting**

The legislation establishes several deadlines for interim and final reports (see below). In addition, several reports will need to be completed (contracted and by staff) to inform the final recommendations report.

a.) Progress Report to Legislature (December 1, 2018)
b.) Follow-up Progress Report that may include initial recommendations (December 1, 2019)
c.) Final report that includes options and recommendations (June 30, 2020)

Specifically, the final report must include options to:

1.) Improve the net rates of return on different classes of assets
2.) Increase the reliability of, and enhance if possible, revenue for trust beneficiaries
3.) Present and explain factors that will (i) define, (ii) constrict, or (iii) define and constrict the DNR’s’s management practices and revenue production. The factors to be considered include, but are not limited to: statutory, constitutional, operational, and social factors

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**Assumptions of This Project**

Below are the core assumptions of this project:

a.) The project is managed effectively
b.) Executive and management support is known and communicated to staff
c.) The project is adequately staffed
d.) The project is adequately funded
e.) The project has clear roles and responsibilities
f.) The project has clear desired outcomes and leadership intent
g.) Appropriate and adequate mitigation measures can be applied to offset risk
Appendices

Appendix A, Authorizing Proviso

ESSB 6095.PL

(1) The Department of Natural Resources must conduct an asset valuation of state lands and state forestlands held in trust and managed by the Department. The analysis required in subsections (3) and (4) of this section may be provided through contracted services.

(2) The Department must describe all trust lands, by trust, including timber lands, agricultural lands, commercial lands, and other lands, and identify revenues from leases or other sources for those lands. The Department must briefly describe the income from these trust lands, and potential enhancements to income, including intergenerational income, from the asset bases of these trusts.

(3) The analysis must estimate the current fair market value of these lands for each trust beneficiary, including the separate beneficiaries of state lands as defined in RCW 79.02.010, and the beneficiaries of state forestlands as specified in chapter 79.22 RCW. The estimation of current fair market values must specify the values by the various asset classes including, but not limited to, the following asset classes: timber lands; irrigated agriculture; dryland agriculture, including grazing lands; commercial real estate; mining; and other income production. The analysis must also estimate the value of ecosystem services and recreation benefits for asset classes that produce these benefits. The Legislature encourages the Department and its contractors to develop methods and tools to allow tracking of the estimated fair market values over time.

(4) For each of the different asset classes and for each of the various trusts, the analysis must calculate the average annual gross and net income as a percentage of estimated current asset value.

(5) The Department must provide a progress report to the Legislature by December 1, 2018. A follow-up progress report is expected to be provided by December 1, 2019, and may include any initial recommendations. The final report is expected to be submitted by June 30, 2020, and must include options to:

(a) Improve the net rates of return on different classes of assets;

(b) Increase the reliability of, and enhance if possible, revenue for trust beneficiaries; and

(c) Present and explain factors that either (i) define, (ii) constrict, or (iii) define and constrict the department’s management practices and revenue production. The factors to be considered include, but are not limited to, statutory, constitutional, operational, and social factors.
Appendix B, Background information

History of trust land management (1)

Granted Lands

As part of the original compact that created Washington, the state received seven land grants for the support of educational (Common Schools, State University, Agricultural, Normal, and Scientific) and other state institutions (Capitol and Charitable, Educational, Penal, & Reform Institutions). Direction and authority for management of these lands was given to the state legislature in the new state’s Enabling Act.

In 1889, on behalf of the people of Washington, the delegates to the state’s constitutional convention accepted the terms offered by Congress for Washington to enter the Union. In Article XVI SCHOOL AND GRANTED LANDS, the people accepted the Grant Lands and agreed to the terms and conditions under which all the trusts were to be managed.

Unlike most other states, Washington has retained most of the trust assets in land. Of the original Educational Grant lands of 2.8 million acres, the state has retained 2.0 million acres, or more than 71 percent. Of the original Institutional Grant lands of 432,000 acres, the state has retained more than 262,000 acres, or 61 percent.

After statehood, an additional 931,000 acres were sold from the other trusts’ holdings, most prior to 1930. Since 1930, the state has had a policy of retaining trust lands rather than disposing of them.

State Forest Lands

The State Forest Lands are the other large class of lands managed by the DNR. The State Forest Lands, about 626 thousand acres, represent about thirty percent of the 2.1 million acres of forested state trust lands. Most of the State Forests are State Forest Transfer lands. These are lands acquired by 21 counties in the 1920s and 1930s through tax foreclosures. Many of these lands had been recently harvested. The other category is the State Forest Purchase lands that were either purchased or acquired as a gift by the state.

The Forest Development Account (FDA) is used to manage the State Forest Lands (formerly known as the Forest Board Lands). See the later discussion of the Resource Management Cost Account, a similar account used to manage the federally granted lands.

1 Most of the material present in this document is drawn from previous works that are listed at the end of the document. In some cases large portions of documents were included word for word. An attempt was made to cite the original documents, but some may have been overlooked. The authors acknowledge the contribution of all those dedicated professionals who, over many years, have documented the rich history of these lands. They have documented the decisions made and the reasoning that lead to the decisions that are State Trust management. Their efforts made the creation of this document possible in a relatively short time. Any errors are our own.
Creation of the Resource Management Cost Account (RMCA)

Prior to the 1957 creation of the Department of Natural Resources, all funds to manage federally granted lands were appropriated out of the state general fund. Reforestation and silvicultural investments had to compete with other needs.

To address the need for funding in what was perhaps the most important innovation of the new Department, the Legislature created the Resources Management Cost Account (RMCA) as a dedicated fund for the management of the granted lands. It has its parallel in the Forest Development Account. The Legislature directed that a percentage of the gross receipts from the granted lands (originally a maximum of 20 percent and increased to 25 percent in 1971) be placed in the RMCA to be used for “defraying the costs and expenses necessarily incurred in managing and administering all of the trust lands . . .” (2) RMCA funds are dedicated to the management and administration of the trust lands from which they were derived and are considered a trust asset and cannot be used for any other purpose unless the trust is compensated.

Beginning in the 1960s, Forest Development Fund (FDF – the predecessor to the Forest Development Account) funds in the account weren’t adequate to meet the management needs of the State Forest Lands, while RMCA funds were in excess of those needed to manage granted lands. The Legislature authorized the DNR to expend the two funds on the management of all State Trust Lands. RMCA funds expended on FDA lands were to be considered a debt against the FDA and FDA funds expended against the RMCA were considered a reduction in that debt. This debt together with interest has been repaid to the granted trusts.

While both the RMCA and FDA expenditures must be appropriated, the availability of dedicated management funds gives DNR somewhat greater independence in establishing long-range management programs for the lands because the Legislature is not being asked to fund management of these lands out of general fund state revenues.

Summary

State trust land management in the State of Washington has evolved and changed dramatically since 1889. Support for the beneficiaries of the granted lands now comes not from the sale of these lands but largely from timber sales, with some additional income increasingly coming from agricultural and grazing uses, mineral development, commercial leasing and the Trust Land Transfer Program (3). Forest Board lands, virtually stripped of trees when originally obtained, are producing valuable harvests of timber once again, providing revenues to the counties in

2 RCW 79.64.030

3 For more information on the Trust Land Transfer Program see the 2003 Report to the Legislature available on the department’s web site at: http://www.dnr.wa.gov/htdocs/obe/reporttoleg/reportleghome.htm
which they are located. Creation of the Department of Natural Resources in 1957 consolidated previously scattered state land management responsibilities in a single agency.

**Legal Construction of the Trust**

The Department’s legal duties regarding forest and other trust lands differ from the obligations of most federal and state land management agencies.

Each state's Enabling Act, Constitution, state statutes and resulting case law illustrate a common core for trust management. Chief among these commonalities are (4):

- The trusts are managed to provide financial support for specific, named beneficiaries,
- The trusts are perpetual,
- The trusts are managed by public entities,
- The trusts are subject to the same federal and state laws as private lands.

In addition to the laws of general applicability, the trusts are subject to specific state law governing the management of the trusts (5).

**Federal Grant Trust**

In 1889, Washington joined the Union under the terms and conditions of the Enabling Act. These conditions included a grant of sections 16 and 36 of every township within the state “for the support of common schools.” Additional grants of land for capitol buildings, for a university, for a penitentiary, for an agricultural college, for a scientific school, for normal schools, and for charitable, educational, penal, and reformatory institutions were made.

The 1889 Enabling Act placed conditions on the grants. For example, grant lands cannot be disposed of except at public sale and for a minimum price of $10 per acre. The proceeds from the sale or permanent disposal of the education grant lands are to be placed in permanent funds, the corpus of which cannot be diminished, and the interest from the permanent funds can only be used to support the named beneficiary. The lands may be leased and timber sold separate from the lands, but only if authorized by the state Legislature (6). The state accepted the grants together with all the terms and conditions under which they were conveyed on behalf of all the people of the state in Article XVI of the state Constitution. The Washington State Constitution placed additional constraints on the management and disposal of the trust lands.

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5 For example, the Washington State Constitution specified that the lands are held in trust for all the people of the state. In the area of forest resources, RCW 79.15.010 provides that "the best interest of the state" must be considered before timber or fallen timber is to be sold. RCW 79.11.175 further requires that the state find "that the best interests of the state may be subserved" before a confirmation of a timber sale is entered.

6 1889 Enabling Act, ch. 17.
The grantor of the trust is the federal government. The primary terms of the trust are contained in the Enabling Act. The trustee is the State of Washington with the Legislature identified as having specific responsibilities under those terms, and the beneficiaries are those named in the Enabling Act. While the trust terms in the Enabling Act and state Constitution give considerable discretion to the state, the courts have ruled on numerous occasions that where the terms of the federal grants are silent, certain common law duties apply.

State Forest Lands

The other major category of trust lands administered by DNR is the State Forest land. There are two types of State Forest lands – the State Forest Purchase and the State Forest Transfer. As the nomenclature implies, these lands are distinguished by how they were acquired. These trusts were created by the state Legislature and the trust terms are contained in state statute. Uniquely, the State of Washington is both the grantor and the trustee.

State Forest Transfer

Among the first environmental and social problems that faced our state was what to do with the deforested lands that were being created by the rapid development of the forest products industry in our state (7). Many landowners did not pay the taxes on forestland, resulting in tax foreclosure.

The 1935 Legislature passed legislation requiring the counties to transfer tax delinquent land suitable for forestry uses to the state for creation of a state forest.

The Legislature created the trust in statute (RCW 76.22.010) (8). The Legislature directed that these lands be held in trust, forever reserved from sale and managed for long-term timber supply on a sustained yield basis.

The grantor of the State Forest Transfer Trust is the State of Washington, the primary terms of the Trust are contained in statute; the trustee is also the State of Washington, and the fiduciary beneficiaries are the junior taxing districts. Since the state is both the grantor and trustee, the state has considerable flexibility to change the terms of the trust through statutory direction. The Legislature has directed that the State Forests are to be managed in the same way and purposes as the federally granted trust lands. The courts have ruled that unless the state Legislature has specifically directed otherwise, common law trust responsibilities apply (9).

State Forest Purchase

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7 See Appendix 2, Forest Board Transfer Lands, Joint Legislative Audit and Review committee Report 96-5 December 16, 1996

8 Hence these State Forest Lands are referred to at “statutory trusts”.

9 Skamania102Wn.2d at 129; see also State ex rel. Hellar v. Young, 21 Wash. 391,392,58p.220 (1899)
The State Forest Purchase lands were acquired under the 1923 Reforestation Act. Under the act, the State Forest Board was given the power to acquire any lands that were chiefly valuable for developing and growing timber, and to designate these lands as State Forest Lands. All State Forest Lands were to be used primarily for forestry, forever reserved from sale. However, the timber could be sold and lands leased in the same way as for the same purposes as state grant lands.

**Uplands Leasing Summary, July 2017 through June 2018**

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<tr>
<th>Lease type</th>
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<td>Dry land/Conservation Reserve Program</td>
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<td>Irrigated crops</td>
<td>32,000</td>
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<td>Orchards and vineyards</td>
<td>18,000</td>
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<td>Grazing</td>
<td>538,000</td>
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<td>Range permits</td>
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**Acres are rounded, sourced from DNR leasing program**
Forest Management Summary, fiscal year 2017 (statewide)

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<td>Thinning</td>
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</tr>
<tr>
<td>Partial cut</td>
<td>4,300</td>
</tr>
<tr>
<td>Biomass</td>
<td>175</td>
</tr>
<tr>
<td>Pre-commercial thinning</td>
<td>16,900</td>
</tr>
<tr>
<td>Pest management</td>
<td>510</td>
</tr>
<tr>
<td>Pruning</td>
<td>700</td>
</tr>
<tr>
<td>Hand planting</td>
<td>15,400</td>
</tr>
<tr>
<td>Site preparation</td>
<td>14,000</td>
</tr>
<tr>
<td>Vegetation management</td>
<td>18,700</td>
</tr>
</tbody>
</table>

Acres are rounded, from data cubes
LDO 20181113