

DATE: 5/12/2010
TO: Interested Parties
FROM: Viola Bay Wild, Senior Fiscal Analyst
RE: Michigan Gas and Oil Lease Revenue

The following contains information concerning the revenue that is received by the State of Michigan from the sale of land oil and gas leases on state-owned lands.

May 2010 State Oil and Gas Lease Auction Information

On Tuesday, May 4, 2010, the State held an oil and gas lease auction for state-owned lands and netted a record \$178.0 million in bonus payments for the State. Up until this sale, the highest amount one auction had ever produced was \$23.6 million in 1981. The State has received a total of \$190.0 million in bonus payments throughout the years since 1929. The recent May 4th auction netted \$178.0 million in one day - which is almost as much as the total amount the State has collected in the last 81 years.

According to the DNRE, the historic auction sale was driven by a recent successful gas flare test at an exploratory test well for natural gas. This well, located about 30 miles southeast of Traverse City in Missaukee County, tapped into a formation known as the Utica Shale. The Utica Shale formation is considered largely undeveloped and exists throughout the Northern Lower Michigan. The new Michigan test well is 600 miles west-southwest of current exploration for Utica shale gas in Quebec's St. Lawrence Lowlands and 400 miles west of exploration in the Appalachian basin around Elmira, New York.

The favorable speculation associated with this successful test well helped fuel the record sales of these leases. In the recent auction, a total of 118,117 acres of state land was leased in 22 counties. Before this sale, the most recent average price paid per acre for a lease was \$26. However, in Tuesday's auction, the average price paid per acre was \$1,507. The highest bid in the auction was \$5,500 per acre for land located in Charlevoix County.

Michigan Natural Resources Trust Fund

All revenues from the sale of oil and gas leases on state lands are deposited into the Michigan Natural Resources Trust Fund (MNRTF) - except for revenue that comes from leases of state-owned lands that were purchased with game and fish protection funds. This latter revenue must be deposited into the Game and Fish Protection Trust Fund. The funding of the MNRTF is to be used to purchase recreational properties and other lands that are characterized by their scenic beauty, and to develop recreational facilities.

The MNRTF was established in Article IX, Section 35 of the Michigan State Constitution and in 1994 PA 451, as amended, Part 19. The Constitution provides for the deposit of these mineral revenues, rentals and royalties into the MNRTF and describes what the purposes are for the Fund. It further provides that the revenues are to be deposited into the Fund until it reaches an accumulated principal balance of \$500.0 million. Until this cap is reached, the Legislature may appropriate up to one-third of all mineral revenues received in a fiscal year to purchase land and to develop recreational facilities. In addition, the Constitution provides that \$10.0 million of the revenues to the MNRTF each year be deposited into the Michigan State Park Endowment fund, but not more than fifty percent of the total revenues from leases and royalties in any given year.

The MNRTF funding for land acquisition projects and recreation development projects is distributed through grants. Both local units of government and State departments may apply for this funding. However, local units of government are required to provide a minimum match of 25%. The MNRTF Board reviews and approves grant applications annually. There are 5 members on the Board: the chairperson of the Natural Resources

Commission and four members appointed by the Governor with the advice and consent of the Senate. The members serve four year terms. The Board's recommendations are submitted to the Legislature in the form of appropriation bills.

Michigan State Park Endowment Fund

When the MNRTF reaches the \$500.0 million cap, the Constitution provides that all mineral revenues that were previously credited to the Fund will be deposited into the Michigan State Park Endowment Fund (MSPEF) for the purposes of operations, maintenance, and capital improvements at Michigan state parks and for the acquisition of lands for state parks.

Article IX, Section 35a of the Constitution and PA 451 of 1994 establish the MSPEF. The Constitution provides that the MSPEF shall receive the mineral revenues from state lands once the MNRTF has reached its \$500.0 million cap until the MSPEF reaches its own cap of \$800.0 million. When the MSPEF reaches this cap, only the interest and earnings in excess of what is needed to maintain the Fund's accumulated principal limit will be available for expenditure. The Constitution also states that once the MSPEF has reached the \$800.0 million cap, the mineral revenues from the bonuses, rentals and royalties shall be distributed "as provided by law". Currently, this distribution mechanism has yet to be addressed in statute. Until the MSPEF has reached its cap, one-half of the annual revenue, plus interest and earnings, may be appropriated by the Legislature for the purpose of operating and maintaining Michigan's state park system.

Fund Balances for MNRTF and MSPEF

According to the DNRE, the current permanent investment corpus of the **MNRTF** at the end of FY 2008-09 was **\$393.8 million**. The permanent investment corpus of the MNRTF is the amount that is referred to in the Constitution concerning the Fund cap of \$500.0 million.

The current permanent investment corpus of the **MSPEF** at the end of FY 2008-09 was **\$136.4 million**. Neither of these two funds has yet met their Constitutional cap of \$500.0 million and \$800.0 million respectively. However, because of the recent record gas and oil lease auction, the MNRTF may come close to reaching its cap in the current year. According to the DNRE, that will depend upon how much of the land that was leased was purchased with Game and Fish Funds and how much the Legislature appropriates of the MNRTF revenue. The MSPEF, however, was still \$663.6 million below its Constitutional limit at the end of FY 2009.

Oil and Gas Lease Revenue Summary

The revenues from the sale of oil and gas leases on state-owned lands are required by the Michigan Constitution to be deposited into the MNRTF, and then the MSPEF after the MNRTF has reached its \$500.0 million cap. The uses for these funds are constitutionally protected through voter-initiated ballot proposals passed in 1994 and 2002.