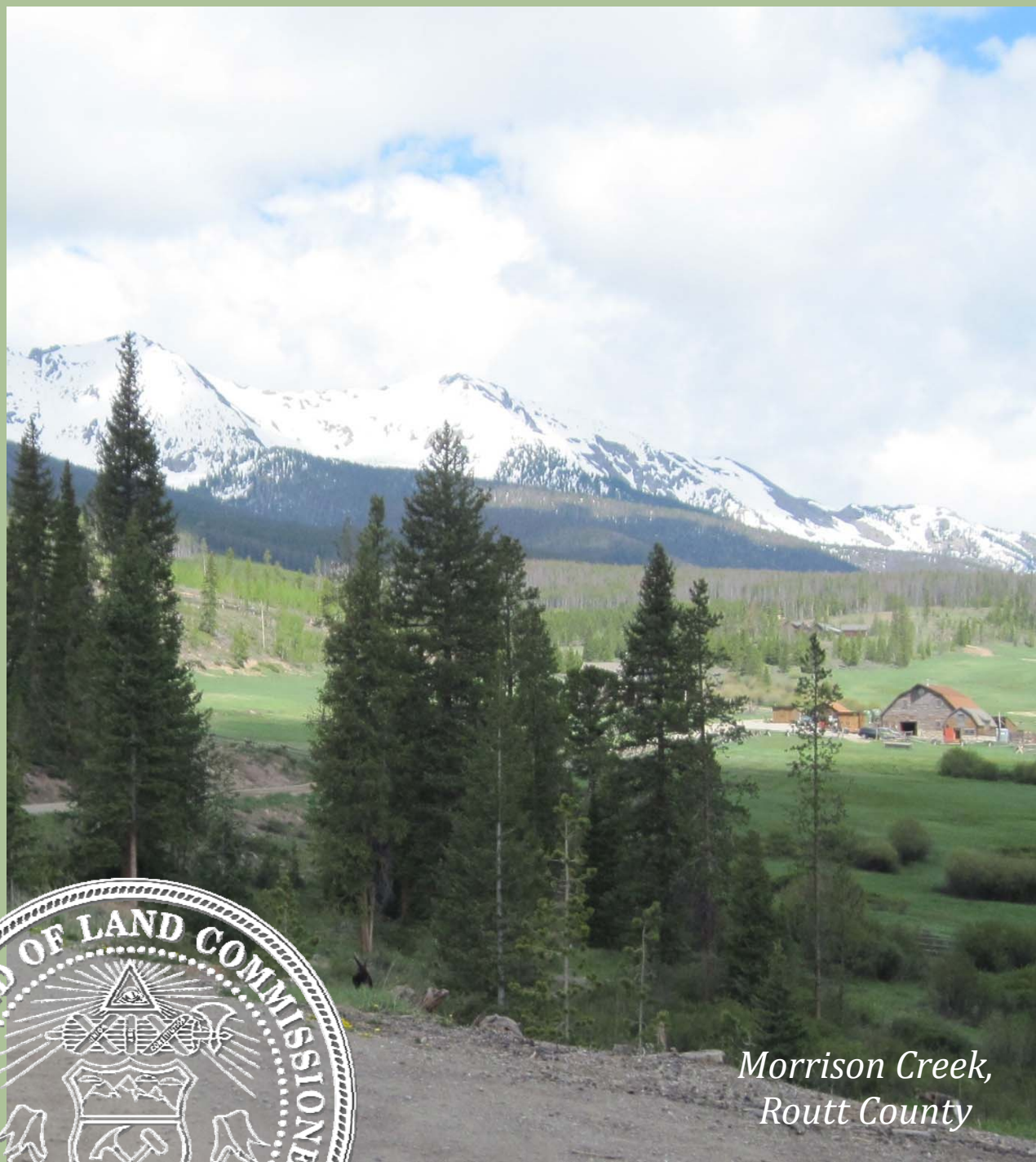


Colorado State Board of Land Commissioners

Annual Report
Fiscal Year 2010-11



*Morrison Creek,
Routt County*





**State Land Board Leadership
Fiscal Year 2010-11**

John Hickenlooper, Governor

**Mike King, Executive Director,
Department of Natural Resources**

Board of Land Commissioners

Michele A. Bloom, President

Tom Hoyt, Vice President

Buck Blessing

Richard Downey

Sandra A. Leinsdorf

Arikaree River, Yuma County



FY 2010-11 Annual Report

EXECUTIVE STAFF

Division Director
Bill Ryan

Deputy Director
Tobin Follenweider

Chief Financial Officer
Mike Trevithick

Acting Minerals Director
Pete Milonas

*Field Operations
Manager*
Beverly Rave

Real Estate Manager
Christopher Smith

DISTRICT OFFICES

Northwest District
Lane Osborn
Craig, Colorado

North Central District
Matt Pollart
Eaton, Colorado

Northeast District
Danny Skalla
Sterling, Colorado

Front Range District
David Rodenberg
Denver, Colorado

Southwest District
Kit Page
Alamosa, Colorado

South Central District
John Valentine,
Pueblo, Colorado

Southeast District
Mike Pollart
Lamar, Colorado

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A Success Story

Highest revenues ever posted & a new direction

The Colorado State Board of Land Commissioners is an agency within state government dedicated to producing revenue to benefit eight different trusts through managing about three million surfaces acres of land and about four million acres of mineral estate. Put in another way, the Colorado State Land Board operates like a \$4B business charged with generating money and managing assets not just for today's shareholders, but shareholders for generations to come.

In March 2011, I joined a team hard at work on a number of important initiatives aimed at facilitating this balance for our trust beneficiaries in a way that achieves "intergenerational equity." During this past fiscal year, the State Land Board adopted an ambitious strategic plan, produced all-time high annual revenues largely due to historic oil and gas leasing, engaged sister state agencies and local government in partnerships, and formed a unique oil and gas development plan on the Lowry Range Property.

The adoption of a new Strategic Plan was a major milestone. The plan's vision captures our desire to "...produce valuable results for each generation of our beneficiaries while sustaining the long term value of the trustlands for future generations." Among many objectives, the Strategic Plan calls for the development of long-term asset management plans, streamlined operational procedures to increase efficiencies and our transparency, and embraces the vision of Amendment 16 throughout increased management of lands held in the Stewardship Trust.

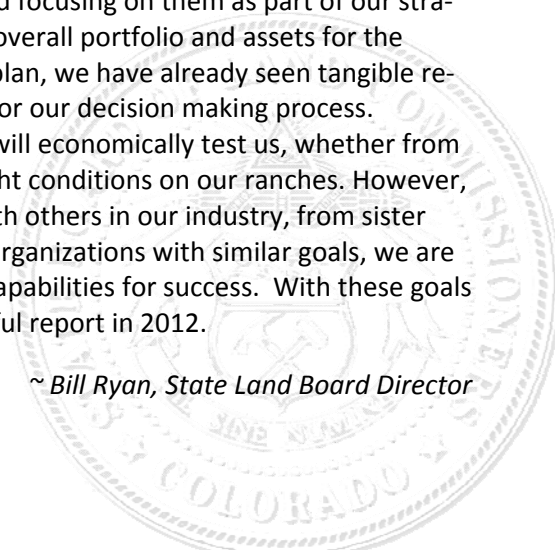
Largely due to unprecedented returns from our minerals estate, our revenues for this fiscal year were more than double the previous year and reached an all-time high of about \$123 million. Trust assets have been of considerable interest for energy companies looking to lease lands as part of the ongoing Niobrara oil play.

One of our biggest accomplishments was the development of a unique oil and gas development plan on the Lowry Range property which balances the Board's long-term stewardship and revenue goals. This 40-square mile parcel has high potential for oil and gas development due to its location within the Niobrara oil play. The parcel also has outstanding values that need to be preserved and enhanced, so a detailed plan was developed to balance stewardship with oil and gas revenues.

By clearly stating these principles and focusing on them as part of our strategic plan, we plan to grow the value of our overall portfolio and assets for the trust. In our first year of implementing this plan, we have already seen tangible results which are providing a strong direction for our decision making process.

We will always face challenges that will economically test us, whether from economic downturns in the market or drought conditions on our ranches. However, when we continue to reach out and work with others in our industry, from sister agencies in state government to non-profit organizations with similar goals, we are able to leverage resources and expand our capabilities for success. With these goals in mind, we look to provide another successful report in 2012.

~ Bill Ryan, State Land Board Director



“Through increased dialogue, we have achieved increased awareness regarding the mission of the State Land Board.”

A New Frontier

The Niobrara play brings all-time high revenues

The lion’s share of the record setting fiscal year 2010 – 11 revenue was generated by our mineral leasing activities throughout the state. Due to recent advancements in horizontal drilling technology and increasing oil prices, parcels that previously were not thought to hold significant value have been leased at record bonus rates generating strong returns for our trust beneficiaries. Existing older oil and gas leases have also benefitted.

The Niobrara shale oil play has turned Colorado into an oil-boom state, providing ample material for discussions about how much oil lies in the shale, how much can feasibly be recovered, and how long the boom will last. The SLB has extensive land holdings in the play in northwestern Colorado, and along the Front Range from the Wyoming border to El Paso County, most significantly in central and western Weld County. The Niobrara play has dramatically changed the operations of oil companies in the region. The direct impact for the State Land Board has been an increase in royalties and bonus revenue, doubling overall revenues from \$66.4 million last fiscal year to \$122 million this fiscal year.

As part of an increased effort to enhance overall communications and participation with local governments and to further address our stewardship obligations, the State Land Board has enhanced the review process for parcels nominated for leasing at our quarterly oil and gas auctions.

We have substantially increased the level of review done on nominated parcels and increased our outreach efforts with local governments and elected officials. Lease nominations are extensively reviewed by staff at the Division of Parks & Wildlife (CDPW) and Local Government Designees (LGDs) for all counties affected by our oil and gas leasing activities. Internally, State Land Board staff members from the Field Operations District offices, Real Estate Section, and GIS teams review the proposed auction list. Our GIS analysis is much more sophisticated, with staff members using detailed maps to review a tremendous amount of data from CDPW, the Colorado Natural Heritage Program (CNHP), the Colorado Natural Areas Program (CNAP), and other natural resources data sources. Lease stipulations are added to address concerns raised by this extensive review process prior to presentation to State Land Board Commissioners for approval. The State Land Board is now able to more effectively guide leasing activities on trust lands, while also protecting the natural values of our parcels.

This enhanced process has also been successful in increasing overall communications with local jurisdiction representatives and elected officials. Through increased dialogue, we have achieved increased awareness regarding activities on state trust lands and the mission of the State Land Board, and we have also identified issues or areas of importance with local elected officials and county representatives. During the upcoming year, as mineral leasing activity continues to intensify, we plan to increase our outreach efforts and the best management practices used to address and minimize the surface impacts of minerals operations.

Charting a New Course

Minerals lease updated for first time in over 20 years

One of the most significant accomplishments made by our agency during this fiscal year was achieved by our minerals team when the State Land Board's updated and revised oil and gas lease form was formally approved. This was a two-year process which involved considerable input from many different parties, with the goal of allowing for oil and gas development while providing a path for the State Land Board to meet both its revenue and sound stewardship obligations on state lands.

The new lease increased the standard royalty rate from 1/8 to 1/6, which is consistent with rates in other neighboring states. This increase will allow the State Land Board to significantly increase revenue generated from oil and gas production, without decreasing our regional competitiveness. The new lease also increased the annual rental rate and adjusted royalty provisions to minimize deductions under legal recognition that royalty owners are non-cost bearing owners.

As a multi-generational land owner, the State Land Board also places a high priority on stewardship and sound land management practices. Revisions were placed into the new lease regarding these stewardship priorities, including the enhanced requirements for surface management plans, strengthened provisions for restoration bonds, notification requirements for violations reported to or discovered by the Colorado Oil and Gas Conservation Commission (OGCC), and notification requirements for operators to provide surface impact documentation to both the OGCC and to the State Land Board.

One of the most important components of the lease revision process was the opportunity to improve our relationships with our partners. The State Land Board worked extensively with representatives from the Colorado Oil & Gas Association (COGA), which provided extensive comments and suggested revisions. By working collaboratively with staff, more than 130 comments were discussed, revised, clarified and addressed. Comments were also received from local government representatives, The Nature Conservancy, the Colorado Division of Parks & Wildlife, industry representatives, and current lessees.

Because of the unprecedented pace of increased oil and gas leasing and development, it will be critical for the State Land Board to continue evaluation of how effectively our lease is working in this current dynamic exploration development market.



In Production

An active oil well in the Coal Creek Basin on the Lowry Range property in Arapahoe County. This site is part of the Niobrara play & could generate large returns for the school trust.

A Vision for the Future

"In the 21st century, Colorado's trustlands will become one of the state's most treasured assets, producing valuable results for each generation of beneficiaries while sustaining the long term value of the trustlands for future generations."

– vision from the State Land Board 2011 Strategic Plan

During this past fiscal year, the State Land Board undertook an extensive initiative to develop a comprehensive new strategic plan for our agency. As challenges and opportunities have been presented to the State Land Board, it was important to develop a vision to address our priorities and align our activities and decisions with our mission. This plan was created with input from a variety of different sources, but most specifically from our staff and beneficiary representatives.

The strategic plan has two guiding strategy elements. First, a portfolio strategy, which is designed to provide a framework for organizing, understanding and optimizing the assets of the trusts. Second, the organizational strategy includes goals for our governance, our internal structure, and both our internal and external communications.

As the long-term economic value of our trust assets is intrinsically tied to the health of the land, one of the key themes in the strategic plan is how the State Land Board can emphasize stewardship responsibilities along with revenue production. We are specifically looking at increased management of lands in the Stewardship Trust, master development plans for the minerals estates of specific large parcels, and exploring new options for producing income from conservation services on trust lands.

The complete 2011 Strategic Plan is on the State Land Board website at www.colorado.gov/trustlands on the main page under the "News and Notices" section.

Expanding our Reach with Relationships

The State Land Board is the second largest landowner in Colorado, which means many acres for a small staff. As such, we work extensively with outside entities and State and Federal agencies to develop collaborative and cooperative relationships. Examples of some of our current cooperative ventures include:

Stewardship Ventures – We work with the Colorado Natural Areas Program, the Colorado Natural Heritage Program, the Colorado Water Conservation Board Drought Mitigation Committee, the Statewide Weed Network and the Cooperative Resources Monitoring Initiative through the Colorado Cattlemen's Association and Colorado State University.

Planning Ventures – We have several large-landscape planning ventures with the Colorado Chapter of The Nature Conservancy, including the Ranchland Database, the Mountains to Plains Energy by Design project with The Nature Conservancy, the City of Fort Collins and Larimer County, and the Colorado Renewables and Conservation Collaborative, which includes TNC, industry representatives, conservation groups, and the Colorado Division of Parks and Wildlife.

Internships/Education Ventures – Through the Colorado Youth Corps, the Leeds School of Business at the University of Colorado, and Western State College.

The First 1165 Transactions

Last fiscal year, the State Land Board received a new tool from the legislature under HB 10-1165, which allows for direct land disposals to another governmental agency. The first two 1165 transactions were completed this fiscal year.

City of Colorado Springs – Manitou Section 16

In December 2010, the State Land Board approved a non-simultaneous exchange with the City of Colorado Springs for 640 acres of land on a section known as Manitou 16 (*pictured at right*). The State Land Board received \$3.8 million for the parcel and retained the minerals



rights under a long-term non-development lease, while the City of Colorado Springs was able to assume surface ownership of a keystone parcel of high importance to the city's open space program.

Arvada Ridge Property — This 5.91 acre parcel in Arvada was originally part of an eighty-year right-of-way used by the Colorado Department of Institutions (currently the Colorado Department of Human Services). The ROW was eventually abandoned. All improvements reverted to the State Land Board and were entered into the Public Buildings Trust. The improvements on the property included components of an old water and sewer system which served DHS structures. The City of Arvada paid \$475,000 for the parcel.

Information about pending and completed HB-1165 transactions will be available on our website at www.colorado.gov/trustlands.

Creating Opportunities for Students Outdoors

In the 2011 Strategic Plan adopted by the State Land Board, one of the goals referred to a sentence in Colorado Statutes, which reads "... trustlands shall be made available to public schools for outdoor education programming at no additional cost ..."

For years, State Land Board staff has worked with local school teachers in various districts in allowing access to trust parcels for educational projects and research. In order to understand the current activities and the possibilities to provide additional resources for outdoor education, staff spent several months researching and collecting information regarding outdoor education opportunities.

The findings from this study proved to be exciting, specifically because of the breadth of opportunities for outdoor education on trust lands across the state. The report identified opportunities for both short-term and long-term projects which could provide additional benefits to various school districts in all regions of Colorado. One of the immediate next steps for this initiative will be to develop an internal tracking system for existing educational opportunities which will make it significantly easier to report on the expansion and progress of outdoor education on trust lands.

The complete Outdoor Education Initiative report is available on the State Land Board website at www.colorado.gov/trustlands in the "News and Notices" section.

Revenue Overview

Reviewing the financials for FY 2010-11

Total revenues in Fiscal Year 2010-11 were \$122.9 million. The School Trust earned over \$120.6 million, with the remaining seven trusts earning the balance of about \$2.3 million combined. Largely due to minerals bonus income, revenues generated in FY 2010-11 represent the highest annual revenues recorded in State Land Board history.

This record-setting revenue was primarily due to:

- Ongoing interest in the Niobrara oil play, which is generating significant interest in minerals leasing and Increased bonus activity, as well as increased oil production;
- Increased oil prices and a more modest increase in production generated higher royalties; and
- Strong royalties from an increase of natural gas well densities in the greater Wattenberg area.

Minerals royalties have been the dominant revenue source for the past five years, and the recent increase in leasing and production in the Niobrara play has been discussed at length throughout this report. This upswing in minerals revenue is expected to continue into the next fiscal year, as oil development continues and more leases shift into production and bring additional royalties to the trusts. Bonus income is expected to remain relatively high and a record number of parcels are expected to be leased at auctions in FY 2011-12.

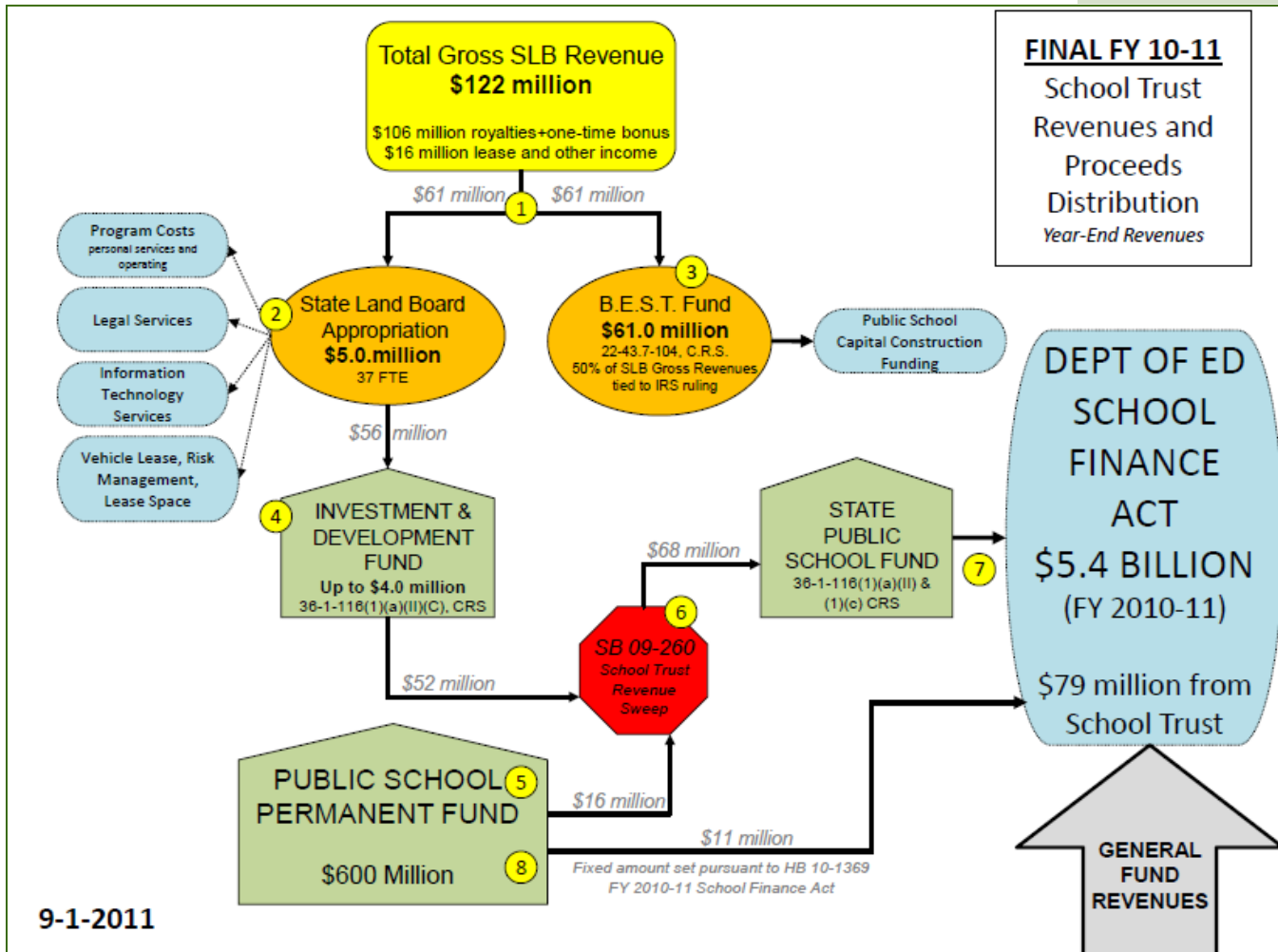
Agricultural and surface revenues, which include rights-of-way and recreation lease revenues, have historically remained consistent with only modest fluctuations. FY 2010-11 was no exception. Surface rental income decreased from approximately \$11.6 million last fiscal year to about \$10.5 million this fiscal year. Some of this decline can be attributed to a short-term delay in processing new rights-of-way. In addition, agricultural revenues have typically decreased in drought years when rent credits were provided to grazing lessees, which may be a consideration in revenue projections for next fiscal year.

Projections for revenues in commercial real estate have remained on target, with expected fluctuations due to anticipated tenant changes and expenditures for necessary asset maintenance. Total commercial revenues decreased slightly in this fiscal year, from approximately \$3.5 million to \$2.8 million, largely because of anticipated expenses for leasing commissions and tenant improvements on several commercial buildings. These expenses were offset by increased revenues from new cell tower leases this fiscal year.

Once the minerals bonus income is backed out of the total revenues earned, the base revenues for the trusts largely comes from five major sources – oil royalties, gas royalties, coal royalties, agricultural rental income, and commercial revenue. Total base revenues have more than doubled over the past decade, with continued growth expected in next several years.

How Trust Revenue is Used

Significant dollars for rural schools through BEST



The table above depicts the distribution of revenues earned by the State Land Board on behalf of the School Trust. Revenues in FY 2010-11 totaled approximately \$123 million. Of that amount, \$61 million was transferred to the Building Excellent Schools Today (BEST) program which supports construction, renovation, and repair of schools in underserved areas of Colorado. Of the remainder, \$52 million was transferred to the State Public School Fund to support the annual operating costs of K-12 education. Another \$27 million of interest from the Public School Permanent Fund was also used to support annual K-12 operating costs. As a result, the balance of the Permanent Fund did not grow appreciably in FY 2010-11.

Investing in the Trust

Fund provides opportunities to add value

What would happen if an owner of a commercial building was unable to put any money into the building for improvements or repairs? The simple answer is that the building would eventually become dilapidated and unusable. This was a similar position the State Land Board used to be in, prior to the formation of a tool which now allows reinvestment into trust assets to increase value or to generate revenue.

In 2005 and again in 2009, the Colorado Legislature created and expanded a fund, called the Investment and Development Fund (I&D Fund). The I&D Fund allows for reinvestment of up to \$5 million of School Trust revenue annually into School Trust assets. The objective is to reinvest into trust assets, in order to increase the overall value and/or generate additional income.

The fund covers some personnel and operating costs, as well as entitlement activities. Some of the projects with the highest returns have related to water improvement projects on agricultural parcels, including irrigation systems and well meters. These long-term investments have shown good returns on both a short- and long-term basis.

Since inception in 2005, the State Land Board's work with the I&D Fund has included:

- Increasing annual recreation and agricultural lease revenues by \$187,800;
- Increasing annual commercial lease revenues by \$1,078,680 million through infrastructure investment, new ground leases, and cell tower leases;
- Increasing property value, which can be realized by the Board over the next ten (10) years as the economy recovers, by more than \$46.6 million through annexation, rezoning and construction;
- Undertaking an oil & gas development project on the Lowry Range in FY 2010-11, which is expected to increase the revenue and valuation from the parcel by more than \$35 million in the next fiscal year; and
- Designing and constructing a LEED certified office building (18,000 sq ft) which generates \$300,000 per year in rent savings and new revenue.

The I&D Fund has a current Net Present Value (NPV) of \$34.8 million, which includes total revenues and total costs including estimated future expenditures and initial opportunity costs, as well as Internal Rates of Return (IRR) for individual projects with a broad range between 7% and 400%.

Since 2005, there have been 28 projects and \$13.2 million in expenditures authorized from the I&D Fund. These projects enhance land value and/or annual income for the School Trust beneficiaries. Among the benefits already derived or expected to be derived from the projects are the following:

- A \$2.2 million increase in annual revenue over the next 10 to 20 years;
- An \$83.1 million increase in property value over the next 5 to 20 years;
- Eleven completed projects have generated \$426,000 of increased annual revenue and three-quarters of a million dollars in increased portfolio value; and
- Use of the \$13.2 million investment from the I&D Fund has leveraged \$8.2 million in additional funding from other sources, including Federal, state, and private contributions.

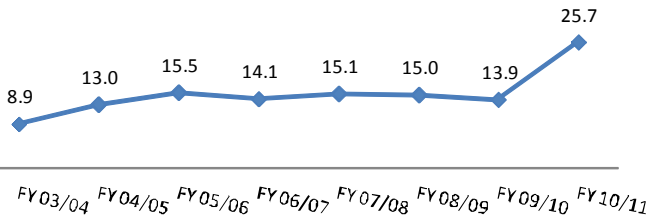
Revenue by Trust and Source - Fiscal Year 2010-11

	School	CU	CSU	Internal Improvements	Saline	Penitentiary	Public Buildings	Hesperus	Forest / Other	TOTAL
Mineral Rental Income	\$ 2,049,480	\$ 1,920	\$ 20,011	\$ 42	\$ -	\$ -	\$ 2,712	\$ -	\$ -	\$ 2,074,165
Mineral Royalty	42,210,215	-	755,695	60,704	-	-	19,608	-	-	43,046,222
Bonus	62,649,071	-	63,724	-	-	-	547,400	-	-	63,260,195
Surface Rental Income	8,222,629	16,383	35,709	65,163	13,209	6,555	8,764	-	9,403	8,377,815
Commercial Revenue	2,414,414	413	354	357,119	-	-	-	-	-	2,772,299
Renewable Energy Income	417,506	-	-	-	-	-	-	-	-	417,506
Other Rental Income	2,301,390	10,560	14,003	24,826	11,995	5,181	500	6,000	-	2,374,454
Timber Sales	-	-	-	-	-	-	-	-	-	-
Land Sales	53,824	-	-	-	-	-	-	-	-	53,824
Interest Income	239,273	54	2,443	1,222	40	5	158,356	36	5	401,435
Fee Revenue	-	-	-	-	-	-	-	-	94,154	94,154
Total Income	\$ 120,557,802	\$ 29,329	\$ 891,938	\$ 509,076	\$ 25,244	\$ 11,741	\$ 737,340	\$ 6,036	\$ 103,562	\$ 122,872,069
Operating Expenses*	4,675,880	2,097	34,704	34,314	1,959	910	27,162	581	698	4,778,306
Fund Transfers	4,000,000	-	-	-	-	-	-	-	-	4,000,000
Net Income	\$ 111,881,922	\$ 27,233	\$ 857,234	\$ 474,763	\$ 23,285	\$ 10,831	\$ 710,178	\$ 5,455	\$ 102,864	\$ 114,093,763

*Note: Total Operating Expenses reported in FY 2011-12 total \$5.1 million due to items funded from sources other than regular trust income.

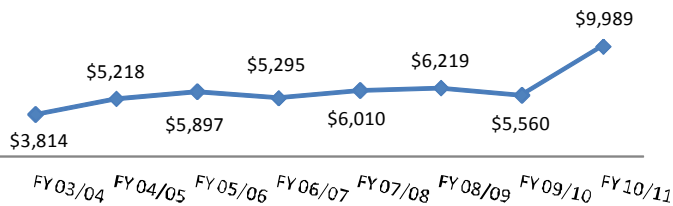
Revenue to Expenses

Revenue earned per dollar of expenditure

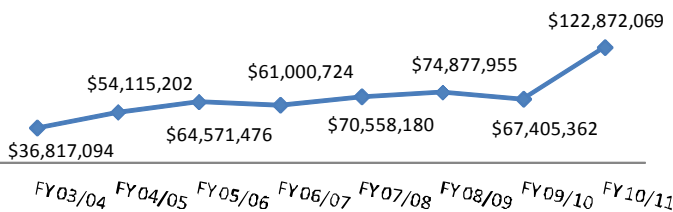


Revenue to Active Leases

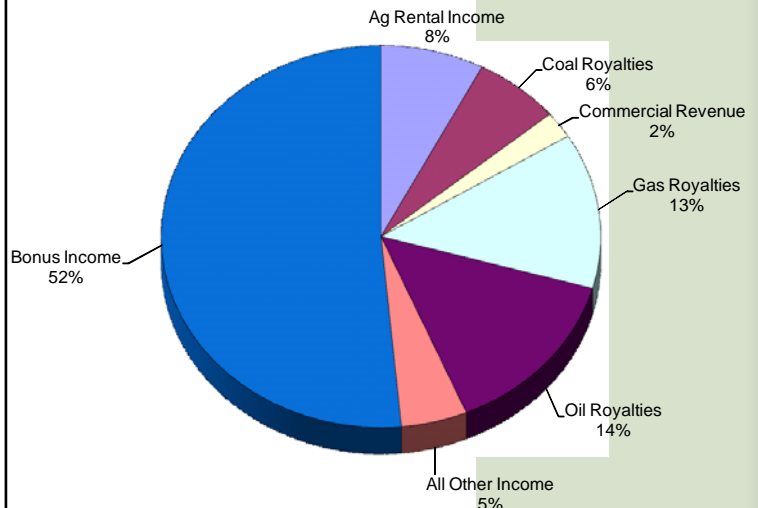
Total revenue earned per active lease



Total Revenue All Sources



FY 2010/11



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Land Commissioners

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The Vision of the State Land Board:

In the 21st century, Colorado's trustlands will become one of the state's most treasured assets, producing valuable results for each generation of beneficiaries while sustaining the long term value of the trustlands for future generations.

For more information:
<http://colorado.gov/trustlands>

