

LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:
Cindy Jorgenson
Angie Grove

MEMORANDUM

TO: Legislative Audit Committee Members
FROM: Joe Murray, Performance Audit Manager
CC: Mary Sexton, Director, Department of Natural Resources and Conservation
Shawn Larson, Administrator, Trust Land Management Division
DATE: December 2011
RE: Performance Audit Follow up (12SP-13): Land Banking Program (orig. 10P-08)
ATTACHMENTS: Original Performance Audit Summary

Introduction

In September 2010, we presented our performance audit of the Land Banking program (program). The audit directed five recommendations to the Department of Natural Resources and Conservation (department). In September 2011, we began gathering preliminary information from department on their progress in implementing the recommendations. This memo summarizes the results of our follow-up work in addition to presenting background information on the program.

Overview

Audit recommendations addressed the need for department to comply with administrative rules regarding land sales appraisals and define what constitutes an appropriate comparable for program sales; consider the short- and long-term financial impacts to trust beneficiaries when trying to sell an isolated parcel with legal access; determine when and where documentation should be retained to support program decisions; establish adaptable statewide guidelines for identifying parcels for sales and acquisitions and take steps to ensure identified parcels fall within these guidelines; and establish a formal process to periodically evaluate the performance of land banking acquisitions. The department has implemented two of these recommendations, and work towards implementing three recommendations is ongoing.

Background

In Montana, the department manages state trust lands on behalf of trust beneficiaries (which include public universities and K-12 schools), under the direction of the State Board of Land Commissioners (land board). The land board is charged with overseeing the management of trust land in the state. The department manages the trust land resources to produce revenue for the trust beneficiaries while considering environmental factors and protecting the future income-generating capacity of the land. The Land Banking Program is one of the many tools the department uses to fulfill this mission. Established by the Legislature in 2003, the program provides the department with the ability to utilize proceeds from the

sale of generally isolated, less-productive trust land to purchase replacement, more highly productive trust land or property improvements which are likely to generate as much or more revenue than the land sold.

Follow-up Audit Findings

The performance audit report contained five recommendations to the department. As part of follow-up work, we examined program materials and interviewed staff from the department. The following summarizes information relating to follow-up audit work and the implementation status of recommendations.

Recommendation #1

We recommend the Department of Natural Resources and Conservation revise their scope of work for program appraisals of property sales to:

- A. Comply with administrative rules.**
- B. Clearly define what constitutes a comparable for program sales.**

Implementation Status – Implemented

In October 2011, the land board approved administrative rule changes sought by the department. These changes “reflect the appraisal scope of work to only provide both values if [appraisers] are able to find comparable sales to support both values”. Recent examples of minimum bid proposals to the land board demonstrate that the department only includes both appraisal values when available.

In regards to comparables, the department says it only contracts with Montana-licensed-and-certified general appraisers. According to department staff, these appraisers by definition comply with the Uniform Standards of Professional Appraisal Practice (USPAP), which contain guidance for developing credible opinions of property valuation. Department staff maintain that “the scope of work for an appraisal need not detail all aspects of each approach to value”. However, for further insurance that appraisers adhere to USPAP, the department sought administrative rule amendments to explicitly require compliance on the part of appraisers to the standards. The land board approved these amendments at their October 2011 meeting. In addition, the program’s scope of work also provides parameters to define an appropriate comparable, such as geographic proximity of the comparable parcel and time elapsed since the comparable parcel sale occurred.

Recommendation #2

We recommend the Department of Natural Resources and Conservation document the consideration of the short- and long-term financial impacts to beneficiaries when trying to sell an isolated parcel with legal access.

Implementation Status – Implemented

The department conducts short- and long-term financial analysis in accordance with state law and administrative rules and now includes this information in the minimum bid proposals they submit to the land board. In addition, the environmental assessment conducted on each sale parcel also analyzes the financial impacts of sale and no sale, with this information being available to land board members and their staff when considering a parcel for sale. While the department’s course of action to implement this recommendation does not specifically address the circumstance of trying to sell an isolated parcel with legal access, for each parcel nominated for sale they provide both short- and long-term economic analysis to the land board to consider, regardless of access. According to department staff, while they provide this analysis to the land board, it is the land board which ultimately sets the minimum value and makes the decision to sell or not sell a parcel. Staff report that it is the land board’s practice to not negotiate minimum bid values for sales. If an isolated parcel valued with legal access is withdrawn from the process

by the individual who nominated the parcel because they think it overvalued, it has been the land board's practice to retain the parcel.

Recommendation #3

We recommend the Department of Natural Resources and Conservation determine when and where documentation should be retained to support program decisions.

Implementation Status – Being Implemented

The department is currently working on new filing policies and procedures and will include these in their next update of the program's handbook—which outlines the policies for the program—and is scheduled to be completed by January of 2012. In addition, to track the whereabouts of program documentation, the department has instituted a check-out card policy to ensure official program files in Helena are not misplaced and department staff know the location of these files at all times.

Recommendation #4

We recommend the Department of Natural Resources and Conservation:

- A. Establish adaptable statewide guidelines for identifying parcels for sales and acquisitions.**
- B. Take steps to ensure identified parcels fall within these guidelines.**

Implementation Status – Being Implemented

At the direction of the 2009 Legislature, which provided bonding authority for the department to purchase 30,000 acres for trust beneficiaries near Potomac, Montana, the department established an asset management plan for trust lands. In response to the audit, department staff indicate that they manage trust land in accordance with this plan. However, the plan is a conceptual document which provides a current snapshot of the trust land portfolio in Montana and models shifts in the portfolio by land class and expected returns. The plan does not define how the activities of the program fit within the broader management of trust land.

According to department management, they are in the process of developing the next phase of the plan, which will provide more individualized direction for identifying parcels for sales and acquisitions, taking in account regional characteristics and overall goals for the management of trust land. This next phase of the plan will provide an on-the-ground tool for regional land management staff when identifying potential parcels for the program, while ensuring sales and acquisitions align with a statewide direction for the management of trust land. Staff report that this next phase of the plan will be piloted in the Western part of the state and ultimately be expanded to all land management regions. They expect this next phase will be in draft format within the next six months.

In regards to ensuring parcels fall within the context of these guidelines, department staff report that trust land staff meet at an annual real estate summit to discuss potential program acquisitions and sales to ensure they meet the criteria established in state law, administrative rules, and the overall goals of the current asset management plan. Moreover, according to staff, they continually review and prioritize potential acquisitions and sales to ensure they meet these various criteria.

Recommendation #5

We recommend the Department of Natural Resources and Conservation establish a formal process to periodically evaluate the performance of land banking acquisitions.

Implementation Status – Being Implemented

The department evaluates the performance of program acquisitions through rates of return on parcels (net income as a portion of purchase price). The department publishes this information in their biannual program report available on the department's website. Department staff stated they decided to report the rates of return on individual parcels for ten years in this report. After that time, they plan to include this data in aggregate form in their annual Return on Assets Report for trust lands, also available on the department's website. While the department has not formalized this process or the ten-year reporting timeframe, department staff indicate they plan to formalize these practices within the program's handbook in the future.

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PERFORMANCE AUDIT

Land Banking Program

The Department of Natural Resources and Conservation

SEPTEMBER 2010

10P-08

REPORT SUMMARY

The Department of Natural Resources and Conservation should improve current Land Banking practices to better balance the short-and long-term impacts to trust beneficiaries.

Context

Established in 2003, the Land Banking Program provides the department with the ability to utilize proceeds from the sale of state trust land to purchase replacement trust land or improvements, which are likely to generate as much or more revenue than the land sold. The program completed its first sale in 2006. To date, the program has sold nearly 42,968 acres of trust land and purchased about 31,588 acres of replacement land. After the completion of audit work, the program acquired an additional 14,581 acres of timber land in July 2010. According to the program, while the land sold generated \$60,644 annually, land acquired is estimated to generate \$303,746 annually, providing greater revenue for trust beneficiaries. Since 2006, the program has acquired ten properties. There have been 504 parcels nominated for sale by the program. Parcels nominated for sale fall into five categories, namely sold, withdrawn, declined, active, and inactive. Of those 504 parcels nominated for sale, 179 parcels have been sold across the state. Other parcels nominated for sale are either under active

consideration of the department or have been removed from consideration for sale by the department or lessee who nominated the parcel for sale. Inactive sale nominations represent nominations which do not fit any of the other categories and are not actively being considered by the department.

Audit work examined how the program values land sold and acquired, determines parcel suitability, and projects rates of financial return on acquisitions. To do this, we reviewed program land sales and acquisitions through February 2010. The majority of parcels sold by the program are isolated without legal public access. Administrative rules for the program require that two appraised values be developed for sales, namely a value with and without access; however, audit work indicated that only 50 percent of appraisals provide both values as required by administrative rules. Audit work also identified inconsistencies in the selection of comparable properties by appraisers to support valuations. While the practice of appraising isolated land with legal access increases the price of a sale, it can also inhibit the program and provide a disincentive for lessees to participate. Audit work demonstrated valuing isolated parcels with legal access increased the appraised price between 20 to 70 percent. Subsequently, participants withdraw from the program. We found approximately 40 percent of participants withdraw from the program due to the appraised price. When a parcel is withdrawn from the program, it generally reverts to the leasing agreement between the department and the lessee, generating limited returns for beneficiaries. When this happens, it can take over 100 years for the department to generate revenue which matches the market value of the land. Presently, the department does not balance the short-and long-term impacts to beneficiaries of trying to sell an isolated parcel with legal access.

**Table 1
Land Sold and Acquired by Land
Classification Through February 2010**

Land Classification	Acres Sold	Acres Acquired
Agricultural	58.4	6,106.1
Grazing	42,907.5	20,806.6
Timber	0	4,257.8
Other	2	417.2
Totals	42,967.9	31,587.7

Source: Compiled by the Legislative Audit Division from department program records.

Audit work also noted a lack of active management for the program. We identified a general deference within the department to allow area land staff to individually

guide program activities rather than adhering to centralized set of practices. We noted inconsistencies in program documentation and the process used to identify suitable candidates for the program. This limited our ability to determine fully if the program is working as the legislature intended. The level of commitment to the program by area land offices varied, with some area land staff more actively engaged than others. Consequently, not all parcels which could be suitable candidates for the program are actively being considered. The department also does not have a formal process to evaluate the ongoing performance of acquisitions to determine if they are performing as expected.

Results

Audit recommendations address the need for the department to improve the appraisal process and strengthen management controls for the program. Recommendations include:

- Complying with administrative rules regarding the inclusion of two values in sales appraisals.

- Defining what constitutes a comparable for program sales.
- Considering the short- and long-term financial impacts to trust beneficiaries when trying to sell an isolated parcel with legal access.
- Determining when and where documentation should be retained to support program decisions.
- Establishing adaptable statewide guidelines for identifying parcels for sales and acquisitions and taking steps to ensure identified parcels fall within these guidelines.
- Establishing a formal process to periodically evaluate the performance of program acquisitions.

Recommendation Concurrence	
Concur	4
Partially Concur	1
Do Not Concur	
Source: Agency audit response included in final report.	