



A REPORT
TO THE
MONTANA
LEGISLATURE

PERFORMANCE AUDIT

*Management of Oil and
Gas and Commercial
Leasing on State Trust
Lands*

*Department of Natural Resources and
Conservation*

OCTOBER 2013

LEGISLATIVE AUDIT
DIVISION

13P-03

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PERFORMANCE AUDITS

Performance audits conducted by the Legislative Audit Division are designed to assess state government operations. From the audit work, a determination is made as to whether agencies and programs are accomplishing their purposes, and whether they can do so with greater efficiency and economy.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Members of the performance audit staff hold degrees in disciplines appropriate to the audit process.

Performance audits are performed at the request of the Legislative Audit Committee which is a bicameral and bipartisan standing committee of the Montana Legislature. The committee consists of six members of the Senate and six members of the House of Representatives.

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October 2013

The Legislative Audit Committee
of the Montana State Legislature:

This is our performance audit of oil and gas and commercial leasing on state trust lands. As part of our audit work, we examined the integrity of the bid process for oil and gas leasing and the identification, issuance, and monitoring of commercial leases. This report concludes controls are in place to ensure the confidentiality of bid nomination information. This report also includes recommendations to improve commercial leasing activities on state trust lands. A written response from the Department of Natural Resources and Conservation is included at the end of the report.

We wish to express our appreciation to department officials and staff for their cooperation and assistance throughout the audit.

Respectfully submitted,

/s/ Tori Hunthausen

Tori Hunthausen, CPA
Legislative Auditor

TABLE OF CONTENTS

Figures and Tables.....	iii
Appointed and Administrative Officials	iv
Report Summary	S-1
CHAPTER I – INTRODUCTION AND BACKGROUND	1
Introduction	1
Audit Objectives.....	1
Audit Scope	1
Oil and Gas Leasing	2
Commercial Leasing	2
Audit Methodologies	2
Areas for Future Study	3
History of Trust Lands	4
Management of Trust Lands in Montana	4
Who Manages Trust Lands?	5
The Minerals Management Bureau	5
The Real Estate Management Bureau	5
Report Contents.....	6
CHAPTER II – OIL AND GAS BIDDING	7
Introduction.....	7
Oil and Gas Leasing Process.....	7
Oil and Gas Leasing Data Trends Do Not Suggest Inappropriate Activities	8
Confidentiality of Bid Information Protects Integrity of Lease Bidding Process.....	11
CHAPTER III – COMMERCIAL LEASE IDENTIFICATION	13
Introduction	13
Commercial Leasing on State Trust Lands	13
Real Estate Identification and Development Requirements on State Trust Lands.....	14
Real Estate Project Identification Criteria	15
The Department Could More Proactively Identify Commercial Leasing Opportunities	16
Trust Lands With Commercial Potential May Not Be Developed	19
What is in the Best Interest of Trust Beneficiaries?.....	24
The Department Should Proactively Identify Commercial Leasing Opportunities.....	24
Other States Actively Identify Commercial Leasing Opportunities on Trust Lands.....	26
CHAPTER IV – COMMERCIAL LEASE ISSUANCE, MONITORING, AND DOCUMENTATION.	27
Introduction.....	27
Appraisal Requirements For Commercial Leases	27
Commercial Leases Are Not Always Appraised	28
Are Beneficiaries Receiving Full Market Value?.....	28
The Department Does Not Believe an Appraisal is Always Needed.....	29
Audit Work Found Limited Evidence of Appraisal Reviews	30
Appraisal Valuations Could Be Better Supported	30
Other State Agencies Routinely Review Appraisals	30
State Law Requires Request for Proposals to Issue Commercial Leases	31
Commercial Leases Are Issued Through a Noncompetitive Process.....	32
Converting Land Use Licenses to Commercial Leases.....	32

Department’s Request for Proposal Process Should Be Consistent33
 The Integrity of the Request for Proposals Process Should Be Maintained.....33
 The Department Has Not Established Policies and Procedures for Request for Proposals
 Process.....34
 State Policy Outlines Requirements for Request for Proposals34
 The Department Could Improve Commercial Lease Monitoring35
 The Department Does Not Ensure Lease Compliance35
 There Are No Policies or Procedures for Monitoring Commercial Leases36
 State Policy Directs Agencies to Monitor Contracts37
 Commercial Leasing Process Needs Better Documentation38
 State Policy Directs Agencies to Establish Management Controls38

APPENDIX A A-1

DEPARTMENT RESPONSE

Department of Natural Resources and Conservation B-1

FIGURES AND TABLES

Figures

Figure 1	Annual Lease Acreage and Bid Average	8
Figure 2	Active Commercial Leases on State Trust Land as of March 2013	14
Figure 3	2012 Real Estate Projects on State Trust Land.....	16
Figure 4	Section 36 Development: 1992 Through 2011.....	18
Figure 5	Current Urban Growth Area Surface Lease Usage on State Trust Land as of March 2013	20
Figure 6	State Trust Land Surface Lease Agreements Surrounding Glendive, Montana.....	22
Figure 7	State Trust Land Surface Lease Agreements Surrounding Kalispell and Whitefish, Montana.....	23

Tables

Table 1	Top Ten Counties with Acreage Leased by Bidder and Price	10
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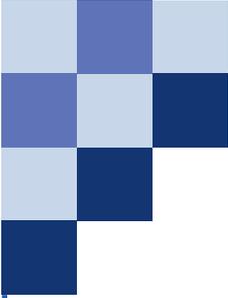
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 MONTANA LEGISLATIVE AUDIT DIVISION

 PERFORMANCE AUDIT
 Management of Oil and Gas and
 Commercial Leasing on State Trust Lands
 Department of Natural Resources and Conservation

OCTOBER 2013

13P-03

REPORT SUMMARY

The Montana Department of Natural Resources and Conservation's (department) controls over the oil and gas bid process ensures that information is secure and not used to inappropriately influence the price of oil and gas leases at public auction. However, the department should more proactively identify commercial leasing opportunities on state trust land to maximize revenue for beneficiaries.

Context

The department generated over \$20 million in gross revenue from approximately 6,100 oil and gas leases in fiscal year 2013. As for commercial leasing, state law outlines the various requirements of the department for commercial leasing on state trust land, including maximizing the long-term revenue accruing to the beneficiaries by issuing commercial leases on land where the chief value exists in its use for commercial purposes. Commercial leases generated approximately \$5 million in gross revenue in fiscal year 2012. As of March 2013, there are 133 active commercial lease agreements on state trust land.

Audit work determined that the department has controls in place to ensure that oil and gas lease bid information is not used to inappropriately influence sale process at public auction. However, during our review, we determined the department should strengthen commercial leasing activities on state trust land by proactively identifying potential commercial leases, complying with appraisal and request for proposal (RFP) requirements, implementing policies and procedures for RFPs and lease monitoring, and documenting commercial leasing activities.

Results

Audit recommendations address the need for the department to proactively identify commercial leases on state trust land and strengthen the identification, issuance, and monitoring of commercial leasing activities on state trust land. Conclusions and recommendations include:

- ◆ Controls over the bid process for oil and gas leases protect the integrity of the lease bidding process.
- ◆ Proactively identify and develop commercial leases on state trust land.
- ◆ Set annual rates for commercial leases based on an appraised value of the land, or seek authority for alternative valuation methodologies.
- ◆ Review and approve land appraisals and document appraisal reviews for commercial lease land appraisals.
- ◆ Issue commercial leases to the highest and best bidder responding to department request for proposals.
- ◆ Develop and implement policies and procedures for request for proposals, including scope, scoring, and selection.

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- ◆ Develop and implement policies and procedures for the physical and financial monitoring of commercial leases.
- ◆ Develop and implement policies and procedures for documenting commercial leasing activities.

Recommendation Concurrence	
Concur	5
Conditionally Concur	2
Do Not Concur	0
Source: Agency audit response included in final report.	

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Chapter I – Introduction and Background

Introduction

The mission of the Trust Land Management Division within the Department of Natural Resources and Conservation (department) is to manage the State of Montana's trust land resources to produce revenue for the trust beneficiaries while considering environmental factors and protecting the future income-generating capacity of the land. Trust beneficiaries include public education institutions such as K-12 schools and universities, which receive trust revenue to support education. The department manages about 11 million acres (surface and mineral acres) of state school trust land, including forest, agricultural, grazing, and commercial properties. Revenue from trust lands is typically generated by leasing the land for some productive purpose, such as agricultural, grazing, residential, mineral, or commercial uses. According to the department's 2012 annual report, state trust lands generated over \$109 million in gross revenue for trust beneficiaries, which includes leasing activities. Based on legislative interest in the management of state trust lands and their financial impact on public education, the Legislative Audit Committee identified a performance audit of the management of state trust land leasing as a priority. This chapter further discusses the scope of our audit work and provides background information on the history of trust lands and the management of trust lands in Montana, including areas within the department where we conducted audit work.

Audit Objectives

During our assessment work, we determined audit work should focus on data confidentiality for the bid process for oil and gas leases; and the identification, issuance, and monitoring of commercial leases. As a result, we developed three objectives for examining the management of state trust land leasing. Our audit work determined if the department:

- ◆ Has controls to ensure the confidentiality of bid information for oil and gas leases to protect the integrity of the lease bidding process.
- ◆ Effectively identifies parcels of state trust land suited for real estate development to maximize revenue for trust beneficiaries.
- ◆ Complies with state law, administrative rules, and applicable policies and procedures for issuing and monitoring commercial leases on state trust lands.

Audit Scope

The subject of leasing on state trust lands spans across many different types of activities, including agricultural, grazing, residential, mineral, and commercial. Considering the breadth of activities related to the management of state trust land leasing, we assessed

the various leasing activities on state trust land to determine where to focus our audit efforts. Our review of leasing activities included agricultural and grazing, minerals, residential, and commercial. Our review did not include timber production on state trust land, as that is considered a permitting rather than a leasing activity. Based on our assessment work, we determined oil and gas and commercial leasing activities merited audit examination. The following paragraphs discuss scoping considerations regarding those areas of trust land leasing in which we conducted audit work.

Oil and Gas Leasing

Our work related to oil and gas leasing on state trust lands focused on the integrity of the lease bid process. Assessment work indicated oil and gas leasing processes in other states have been compromised by external parties obtaining the identities of applicants prior to public auction and using that information to influence the sale price of leases at public auction. Bid information is to be held confidential in Montana until after an oil and gas lease sale. Due to the high volume of oil and gas leasing on state trust lands, we examined department controls over the integrity of bid information. The bid process for oil and gas leases was examined to determine if department controls ensure bid information is secure and not being used to inappropriately influence the price of oil and gas leases at public auction.

Commercial Leasing

The processes by which commercial leases are identified, issued, and monitored, including how commercial leases are appraised and minimum lease payments established, were reviewed to determine if these activities are consistently conducted by the department and in compliance with applicable requirements. Assessment work indicated that commercial leasing for trust lands is a fairly new concept as compared to other leasing activities and presents an opportunity for increasing the amount of revenue for beneficiaries over traditional leasing activities such as agricultural or grazing. This circumstance raised concerns regarding if commercial leasing activities were being conducted consistently by department staff and as defined in law, administrative rules, and department policy. Assessment work also questioned the department's process to identify commercial leasing opportunities on state trust land. Consequently, our audit examination assessed whether the department actively pursues commercial leasing as a means to maximize revenue for trust beneficiaries.

Audit Methodologies

To accomplish our objectives, we completed the following methodologies:

- ◆ Reviewed trends related to oil and gas bidding from 2002 through 2012.

- ◆ Observed department processes for receipt and processing of oil and gas bids for the department's March 2013 public auction to assess process consistency and compliance with applicable data integrity requirements.
- ◆ Tested data security controls on the department's Trust Land Management System database to verify that only appropriate department staff have access to oil and gas bid information.
- ◆ Obtained and reviewed applicable state laws, administrative rules, and department policies for data confidentiality for oil and gas bids and the identification, issuance, and monitoring of commercial leases.
- ◆ Interviewed department staff in Helena and within each of the department's six area land offices to discuss leasing activities.
- ◆ Obtained and reviewed information for oil, gas, and commercial leasing activities, including interviews, on state trust lands in other states.
- ◆ Obtained and reviewed data for all surface leasing agreements on state trust land as of March 2013 to determine what surface leasing agreements exist and if there is potential for additional commercial leasing opportunities.
- ◆ Obtained and reviewed annual revenue for commercial leases on state trust land to determine if commercial leases increase long-term revenue for beneficiaries.
- ◆ Reviewed management information used by the department to monitor commercial leases to determine what type of information is available to the department to direct monitoring activities.
- ◆ Reviewed department files for the 2012 real estate projects to assess how projects are identified, evaluated, and selected.
- ◆ Reviewed department files for applicable commercial leases issued by the department since commercial leasing activities were defined in state law in 2003 to assess process consistency and compliance with applicable requirements, including 21 commercial leases for obtaining appraisals, 21 commercial leases for issuing Request for Proposals (RFPs), and 23 commercial leases for conducting monitoring activities.
- ◆ Interviewed stakeholders who have identified and leased state trust land for commercial purposes.
- ◆ Interviewed appraisers who have appraised state trust land for commercial purposes.

Areas for Future Study

During the course of our audit work, we determined that there were a couple of areas related to oil and gas leasing which would merit attention for future audit work. Those areas include:

Oil and Gas Lease Monitoring - As part of the oil and gas leasing process on state trust land, the department is responsible for establishing specific lease stipulations to ensure the issuance of an oil and gas lease will not adversely impact the tract, including limiting areas for drilling due to accessibility, existing surface leases, or the presence of a wildlife corridor. While the department establishes lease stipulations, the department conducts limited monitoring of oil and gas leases on state trust land to ensure lease holders are in compliance with lease stipulations. Future audit work could examine the process by which the department monitors oil and gas leases to ensure state trust lands are not adversely impacted by oil and gas leasing.

Oil and Gas Royalty Payments - In addition to annual rental payments received by the department for oil and gas leases, the department also receives royalty payments for producing wells. The department has raised royalty rates in the past several years to align with neighboring states and industry standards. Presently, the royalty rate is a 1/6 share of production for beneficiaries. To ensure that the department receives the maximum amount of revenue due to trust beneficiaries, the department established a royalty audit program to identify royalty under- and over-reporting, rectify discrepancies, and raise the level of compliance on the part of lease holders. Future audit work could examine the royalty audit process to examine how the department selects audits and ensures they are obtaining the maximum amount of revenue due to trust beneficiaries.

History of Trust Lands

As part of the various federal enabling acts authorizing the admission of new states into the United States, newly formed states were granted lands from the federal government to support a public education system, commonly known as trust lands. Over time, many states have chosen to sell these lands and place the proceeds into a permanent “trust fund” to be used for the purpose of generating revenue for beneficiaries. Trust beneficiaries include the public education institutions such as K-12 schools and universities which receive trust revenue to support education. However, a number of other states, mainly in the western part of the United States, have chosen to hold onto these lands and manage the property to generate revenue for trust beneficiaries.

Management of Trust Lands in Montana

In Montana, the Enabling Act of 1889 and subsequent acts granted acreage for various education institutions across the state, including K-12 schools and public universities. The current total acreage, including both mineral and surface acreage, exceeds 11 million acres. The distribution of trust revenue to beneficiaries varies based on the purposes outlined in the granting acts. Rental income, lease income, interest earned on the permanent funds, other interest earnings, and all other income may be distributed to beneficiaries for the maintenance and support of the educational institutions, or beneficiaries.

Who Manages Trust Lands?

The Montana Department of Natural Resources and Conservation's (department) Trust Land Management Division (division) manages trust lands on behalf of trust beneficiaries, under the direction of the State Board of Land Commissioners (land board). The land board consists of five statewide elected officials, including the Governor, the Attorney General, the Superintendent of Public Instruction, the State Auditor, and the Secretary of State. The land board is charged with overseeing the management of trust land in the state. It is their responsibility to decide how to best generate revenue for beneficiaries. The mission of the division is to manage the state's trust land resources to produce revenue for the trust beneficiaries while considering environmental factors and protecting the future income-generating capacity of the land. Division activities for the management of trust lands are divided into four bureaus, including the Minerals Management Bureau (MMB), the Real Estate Management Bureau (REMB), the Forest Management Bureau, and the Agriculture and Grazing Management Bureau. Programs include timber harvesting and forest improvement; oil, gas and other minerals leasing; commercial real estate development; easements and cabin-site leases; agricultural and grazing leases; and recreational use. Our audit work focused on activities conducted within the MMB and the REMB.

The Minerals Management Bureau

The MMB is responsible for leasing, permitting, and managing oil and gas, metalliferous and nonmetalliferous, coal, and sand and gravel agreements on 2 million acres of trust lands. As of July 2013, the largest of these activities is oil and gas leasing, with 6,138 oil and gas leases, of which 669 are currently productive. The leasing process may vary between the different products extracted; however, process activities generally include: administering lease bidding, reviewing and approving leases, collecting and verifying lease payments and production royalties, and monitoring physical operations on state leases. The leasing conducted by the MMB represents the majority of leasing activities on state trust lands. According to the department's 2012 annual report, the MMB generated over \$45 million in gross revenue in fiscal year 2012. The administration of oil and gas activities occurs in Helena, with staff in each of the department's six area land offices regionally managing these activities. In fiscal year 2013, the full-time equivalent (FTE) for the MMB is 10.25, with a budget of \$683,639.

The Real Estate Management Bureau

The REMB manages all activity on trust lands that are not classified as grazing, agriculture, or timber. These "other" surface tracts are administered for the benefit of each trust through leasing, short-term licenses, land exchanges and sales, and through issuing right-of-way agreements. The REMB generated over \$10 million gross revenue

for trust beneficiaries in fiscal year 2012, according to the department's 2012 annual report. The bureau manages the leasing and development of trust land for commercial and residential purposes. Commercial leasing development may include facilities such as retail locations, wind farms, or communication sites. A commercial lease—as opposed to a residential lease—is a contract between a business and a landlord for the rental of property or building space for a business purpose. The REMB is responsible for real estate project development on state trust lands. A real estate project is a proposal initiated by the bureau to develop state trust land for a commercial, industrial, residential, or conservation use, or a public facility where no such use existed previously, which requires some level of local government involvement and approval such as annexation or subdivision approval. Commercial leases are a category of real estate project development. In fiscal year 2013, the FTE for the REMB is 9.88, with a budget of \$908,175. This budget includes \$104,400 for real estate development.

Report Contents

The remainder of this report includes chapters detailing our findings, conclusions, and recommendations in the following areas:

- ◆ Chapter II discusses the bid process for oil and gas leases on state trust lands and how the department's current controls assure that bid information is not being used inappropriately.
- ◆ Chapter III addresses how the department should proactively identify commercial leasing opportunities on trust lands.
- ◆ Chapter IV discusses how the department should improve commercial lease issuance, monitoring, and documentation activities.

Chapter II – Oil And Gas Bidding

Introduction

Our first audit objective examined if the Department of Natural Resources and Conservation's (department) current controls ensure the confidentiality of bid information for oil and gas leases to protect the integrity of the lease bidding process. The department's Mineral's Management Bureau (MMB) is responsible for issuing oil and gas leases on state trust land. Over the course of our audit, we concluded that the department's current controls over the bid process provides an assurance that bid information is secure and not being used to inappropriately influence the price of oil and gas leases at public auction. The remainder of this chapter discusses the oil and gas bid process, current data trends in oil and gas leasing on state trust lands, and provides information on how we reached our conclusions.

Oil and Gas Leasing Process

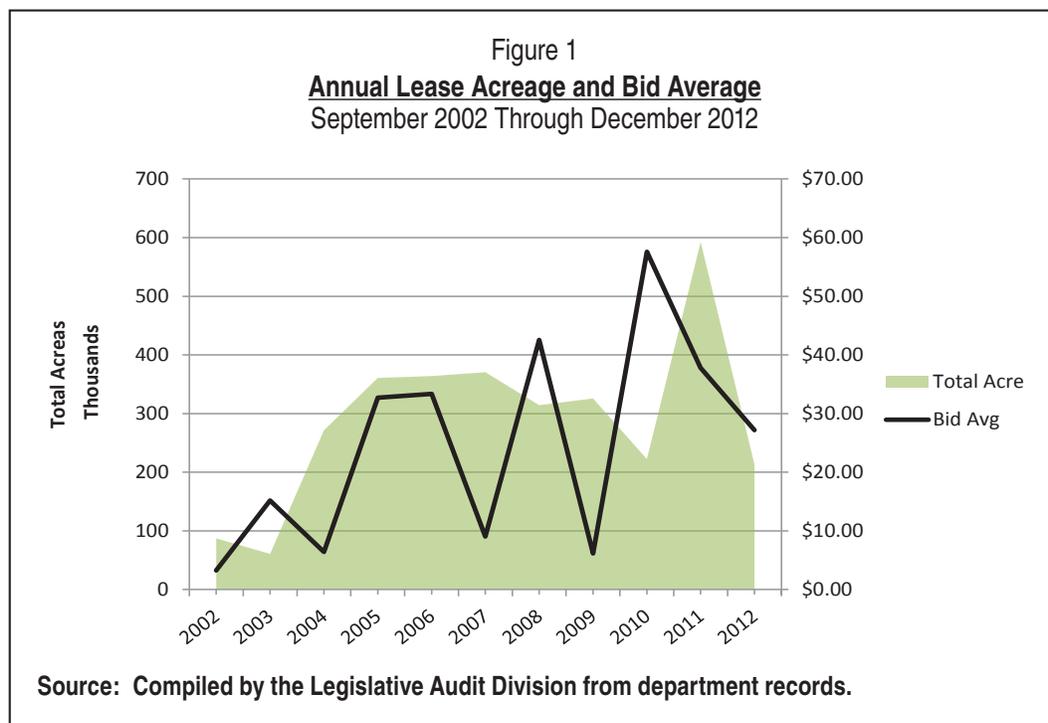
The department conducts quarterly lease auctions for oil and gas leases on state trust land. These are public auctions, where any member of the public may place a bid on a tract of state trust land nominated for an oil and gas lease. Anyone may nominate a tract of state trust land for an oil and gas lease by completing a nomination form identifying the tract of trust land in which they are interested and paying a \$15 application fee. By nominating a tract of trust land for lease, the individual who nominated the tract is agreeing to pay the minimum bid per acre defined in state law. Section 77-3-423 (1), MCA, indicates that the annual rental paid to the state for oil and gas leases may not be less than \$1.50 for each acre of land leased. However, leases sold at public auction routinely sell for more than the statutory minimum. Any bid price in excess of the statutory minimum is referred to as the bonus bid. In addition to the minimum \$1.50 per acre, the rental for the first year of the lease must also include the bonus bid per acre offered and accepted at auction. For example, if a lease were sold at public auction for \$5 per acre for a 640 acre section of state trust land, the statutory minimum would be \$960; the bonus bid would be \$2,240. Oil and gas leases are ten-year agreements. The lessee may cancel the lease at any time after paying the first year's rental. The bonus bid is only payable for the first year for the ten-year agreement. Years two through ten would only include the statutory minimum. In addition to this annual rental, the department would also receive royalty payments for producing wells. The department generated over \$20 million in gross revenue from oil and gas lease rentals in fiscal year 2012 according to the departments 2012 annual report.

Nominations for an oil and gas lease must be received by the department at least three months prior to the quarterly public auction so the department can process the nomination. Nominations are received in Helena. Department staff record nomination

information, including the identity of the nominator, within the department's database used for managing all trust land activities. During this process, department staff review the nominated tracts for suitability and establish specific lease stipulations to ensure the issuance of an oil and gas lease would not adversely impact the tract. For example, lease stipulations may include excluding certain areas for future drilling due to accessibility, existing surface leases, or the presence of a wildlife corridor. After internal review and prior to the public auction, the department will publish a final list of the nominated tracts, which includes any lease stipulations. This list does not include the identity of the nominator. This list is sent out to interested parties, published on the department's website, and used during the quarterly public auction. After the quarterly auction, the department creates a final sale list, which includes the name of the successful bidder. The successful bidder may or may not be the same individual who nominated the tract. Once there is a successful bidder, the Montana Board of Oil and Gas Conservation is responsible for permitting any oil wells which may be drilled on state trust lands with oil and gas leases.

Oil and Gas Leasing Data Trends Do Not Suggest Inappropriate Activities

As part of our audit work, we reviewed bid information from September 2002 through December 2012 to assess trends related to oil and gas leases on state trust land. We reviewed this information to determine if there were any data trends relative to oil and gas bidding which may suggest an inappropriate use of bid nomination information. Figure 1 illustrates the annual acreage of state trust lands leased for oil and gas development and the average bid per acre paid at quarterly lease auctions.



As illustrated by the figure, the total acreage leased rose gradually in 2003 and remained fairly steady until 2009, after which it rose sharply in 2011 and dropped sharply in 2012. In comparison, the average bid per acre generally rose and declined sharply every other year. According to department staff, these fluctuations in acreage and average bid can be generally attributed to market forces both locally and internationally, which includes periods of increased speculation in Eastern Montana, overall swings in world oil prices, and developing technology. For example, the general increase in total acres leased beginning in 2003 is likely attributable to the discovery of the Elm Coulee Oil Field in the Williston Basin in Richland County in 2000. This field produces oil from the Bakken formation, an area occupying about 200,000 square miles underlying parts of Montana, North Dakota, Saskatchewan and Manitoba. The fluctuations in the average bid per acre are related to speculation in oil prices. When the market is high and prices elevated, oil development and exploration increases. Similarly, when the market is down and prices have declined, development and exploration decreases. Based on our audit work, we did not detect a trend in the bid nomination data which would suggest that the information is being used to inappropriately influence the prices of oil and gas leases at public auction.

CONCLUSION

Oil and gas leasing data trends on state trust lands do not suggest that bid nomination information is being used to inappropriately influence annual rentals for oil and gas leases.

As part of our review of bid information to assess trends, we also examined the relationship between the number of oil and gas development companies bidding on oil and gas leases in each county and the bid price paid at public auction. We did this to determine if there were any data trends to indicate fewer development companies bidding on oil and gas leases resulted in a lower price paid on annual rentals. Table 1 illustrates the top ten counties with the highest amount of leased acreage from January 2008 through December 2012, the number of development companies which bid on oil and gas leases during that time frame, and the average, minimum, and maximum bid per acre.

Table 1
Top Ten Counties with Acreage Leased by Bidder and Price
 January 2008 Through December 2012

Counties	Total Acres Leased	Number of Companies Bidding	Average Bid Per Acre	Minimum Bid Per Acre	Maximum Bid Per Acre
Judith Basin	141,860	2	\$4.97	\$1.50	\$53.00
Chouteau	110,732	8	6.29	1.50	31.00
Daniels	102,773	18	36.98	1.50	300.00
Fergus	101,177	7	6.75	1.50	100.25
Cascade	93,347	12	2.21	1.50	19.50
Dawson	91,680	18	61.21	13.00	1,555.00
Hill	91,501	11	9.38	1.50	160.00
Beaverhead	84,259	6	4.70	1.50	15.00
Lewis and Clark	76,723	16	10.57	1.50	52.00
Teton	68,851	21	37.07	1.50	390.00

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

As illustrated by the table, the total acreage leased in these counties ranges from nearly 70,000 acres to over 140,000 acres, with the number of oil development companies bidding on these leases ranging between two and twenty-one. The majority of these counties are located in Central Montana, with the exception of Beaverhead County in the Western part of the state and Daniels and Dawson Counties located in the Eastern part of the state. According to department staff, this data confirms the oil and gas lease bidding process is competitive in nature and there are multiple companies bidding on oil and gas leases, making it difficult for companies to collude with each other to inappropriately influence the rental price for leases. With the exception of Judith Basin, there are numerous development companies bidding on oil and gas leases in each county. While only two companies bid on oil and gas leases in the past five years in Judith Basin, a review of the minimum and maximum price paid per lease during that time frame for the top ten counties indicates the number of bidders does not appear related to the price paid per acre. For example, while there have only been two bidders in Judith Basin with a maximum bid of \$53 per acre paid, there were 12 bidders in Cascade County with a maximum bid of \$19.50 paid per acre. Similarly, there were eight bidders in Chouteau with a maximum bid of \$31 paid per acre. According to department staff, when oil and gas development companies take an interest in a particular region, this often results in increased speculation and drives an increase in rental rates on leases. Conversely, bonus rates will decline as

speculation decreases. Based on our audit work, we did not detect a trend suggesting oil development companies were inappropriately influencing the rental price for leases.

CONCLUSION

Oil and gas leasing data trends on state trust lands do not suggest a relationship between the number of oil and gas development companies bidding on oil and gas leases and the price paid for annual rentals at public auction.

Confidentiality of Bid Information Protects Integrity of Lease Bidding Process

Per department policy, applicant names are confidential until after an oil and gas lease sale. The integrity of the leasing process relies on the confidentiality of bid nomination information. As oil prices rise and oil development companies engage in additional speculation activities, the integrity of the bid nomination process increasingly becomes important to ensure that trust beneficiaries are receiving competitive annual rentals. During assessment work, we determined that oil and gas leasing processes in other states have been compromised by external parties obtaining the identities of applicants prior to public auction and using that information to inappropriately influence the sale price at the auction. For example, if two external parties were to become aware of the tracts of trust land which they independently nominated for an oil and gas lease, those parties could collude with each other and refrain from bidding on the tracts nominated by the other party in an effort to lower the sale price for each other. Considering the high volume of rental revenue generated by oil and gas leases, we determined it was appropriate to test the controls over the integrity of the bid nomination information to ensure that bid nomination information is not being inappropriately used at public lease sales and trust beneficiaries are receiving the greatest amount of revenue possible.

As part of our audit work, we observed the bid nomination process for the March 2013 lease sale and tested department controls over bid nomination information to assess if those controls protected the integrity of bid information. Our review of department controls also included an assessment of the integrity of the department database used to house lease nominations for oil and gas leases. The bid information for oil and gas leases is housed within a separate module within the database, with access limited to only relevant department staff. Based on audit work, information reviewed by staff outside of those who receive and process nominations does not include the identity of the nominator. Additionally, audit work determined outside of staff who receive and process nominations, there is restricted access to the specific module within the

department's trust land management database which contains nomination information for oil and gas leases. We determined department staff follow established policy regarding maintaining the confidentiality of bid applicant information. Based on our audit work, we determined the integrity of nomination information is maintained and that current department controls ensure information is secure and not being used to inappropriately influence the price of oil and gas leases at public auction.

CONCLUSION

The Department of Natural Resources and Conservation's controls over bid nomination information protect the integrity of the lease bidding process.

Chapter III – Commercial Lease Identification

Introduction

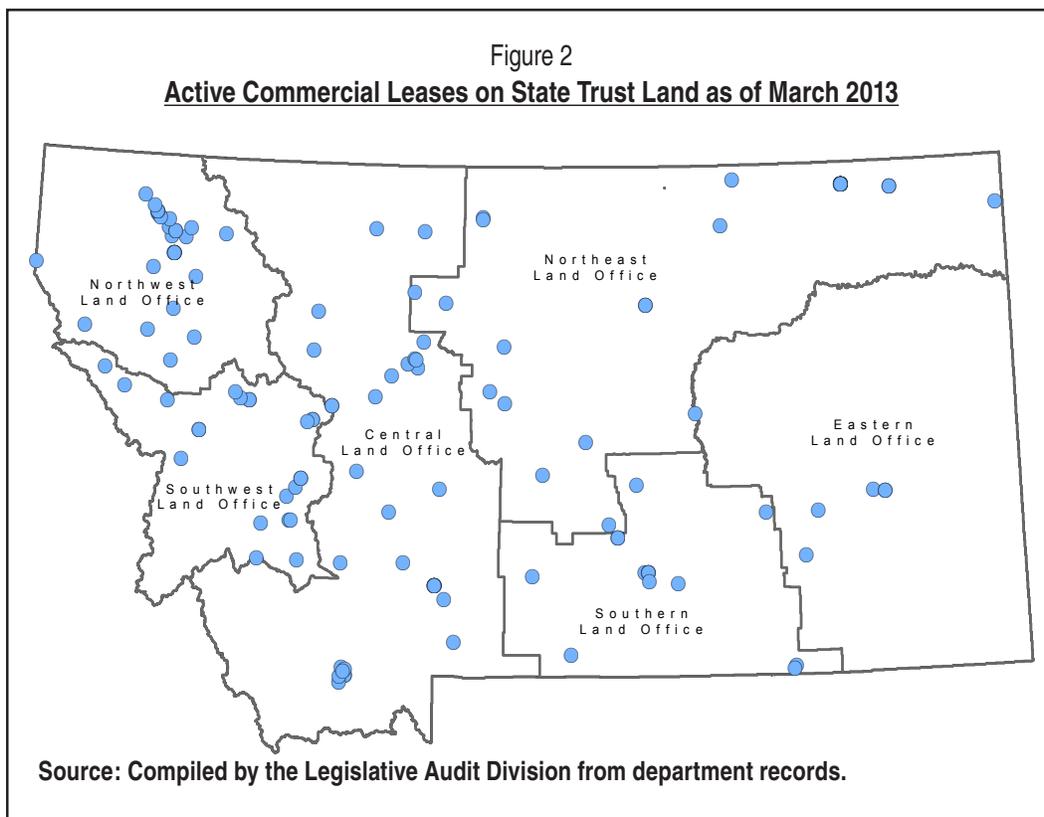
In Montana, state trust lands with potential for commercial leasing are identified and evaluated for suitability within the context of the Department of Natural Resources and Conservation's (department) process for developing real estate opportunities on trust lands. The department's Real Estate Management Bureau (REMB) is responsible for identifying commercial leases on state trust land. As part of our second objective, we examined how the department identifies commercial leases on state trust land in order to maximize revenue for trust beneficiaries. We determined the department could improve how it proactively identifies commercial leasing opportunities on trust lands. This chapter provides background information on the relationship between real estate development and commercial leasing. This chapter also presents our findings, conclusions, and recommendations to strengthen how the department identifies commercial leasing opportunities on state trust land to increase long-term revenues for trust beneficiaries.

Commercial Leasing on State Trust Lands

Established by the Legislature in 2003, the purpose of commercial leasing on state trust lands is to implement Article X of the Montana Constitution and manage state trust lands in the best financial interest of current and future beneficiaries. Sections 77-1-901, MCA, through 77-1-912, MCA, outline the various requirements of the department for commercial leasing on state trust land, including maximizing the long-term revenue accruing to the beneficiaries by issuing commercial leases on land where the chief value exists in its use for commercial purposes. State law defines a commercial lease as a contract to use state trust lands for a commercial purpose, such as an industrial enterprise, retail sales outlet, business and professional office building, warehouse, motel, hotel, hospitality enterprise, commercial or concentrated recreational use, multifamily residential development, and other similar business. State law excludes agriculture; grazing; exploration or development of oil and gas, mineral, and geothermal resources; single-family residences, home sites, and cabin sites; and utility rights-of-way. While the administration of commercial leases is centrally located in Helena, the majority of commercial leasing activities take place in one of the department's six area land offices, which regionally manage state trust lands.

Per state law, commercial leases are awarded through a competitive request for proposals (RFP) process. State law establishes an annual minimum rental rate for commercial leases based on the appraised value of the land. Section 77-1-912, MCA, provides for rule making authority for the department to establish procedures for the issuance of requests for proposals for commercial purposes and the commercial

leasing of state trust land. To this end, the department established administrative rules in 2008 outlining standards for real estate project development, including a project evaluation, review, and selection process. Commercial leases are a category of real estate project development. Real estate project development in the context of commercial leasing will be discussed later in this chapter. The RFP and appraisal processes will be discussed further in Chapter IV of this report. According to data provided by the department, commercial leases generated approximately \$5 million in gross revenue in fiscal year 2012. According to department data, as of March 2013, there are 133 active commercial lease agreements on state trust land, as illustrated by Figure 2 below.



Real Estate Identification and Development Requirements on State Trust Lands

State law does not specifically speak to the identification process for real estate development, including trust land suited for commercial leasing. However, in 2005, the department developed and established the Real Estate Management Plan (REMP). This plan establishes overall policy, direction, and guidance in the identification and selection of real estate development on trust lands. The purpose of the REMP is to provide the department with consistent policy, direction, and guidance in the selection and management of real estate development on state trust lands. The REMP is a guide

for identifying and selecting future real estate projects on state trust land and provides criteria, goals, and evaluation tools for real estate management on trust lands. The three goals outlined in the REMP include:

- ◆ Sharing in expected community growth.
- ◆ Planning proactively.
- ◆ Increasing revenue for trust beneficiaries.

In an effort to implement the REMP, the department established administrative rules for real estate management projects. The rules define a real estate project as a proposal to develop state trust land for a commercial, industrial, residential or conservation use, or a public facility where no use existed previously. The rules outline general development standards and a project evaluation, review, and selection process for real estate projects; there is limited guidance in administrative rules in terms of how parcels are initially identified to go through the evaluation, review, and selection process. However, the rules do state that the department will actively pursue commercial, industrial, residential, and conservation uses to increase revenue on trust lands. The department also established additional procedures in 2010 to provide guidance for staff for implementing the REMP and administrative rule. The department's Real Estate Project Review and Selection (REPRS) Manual outlines an annual selection process for real estate projects and the roles and responsibilities of department staff to be conducted in compliance with the REMP and the administrative rules for real estate management. However, the manual does not provide direction for staff in terms of what factors should guide the identification of potential parcels.

Real Estate Project Identification Criteria

Relative to project identification, the REMP defines which geographic areas are the primary focus for real estate development on state trust lands, which includes commercial leases. Location criteria identified in the plan includes:

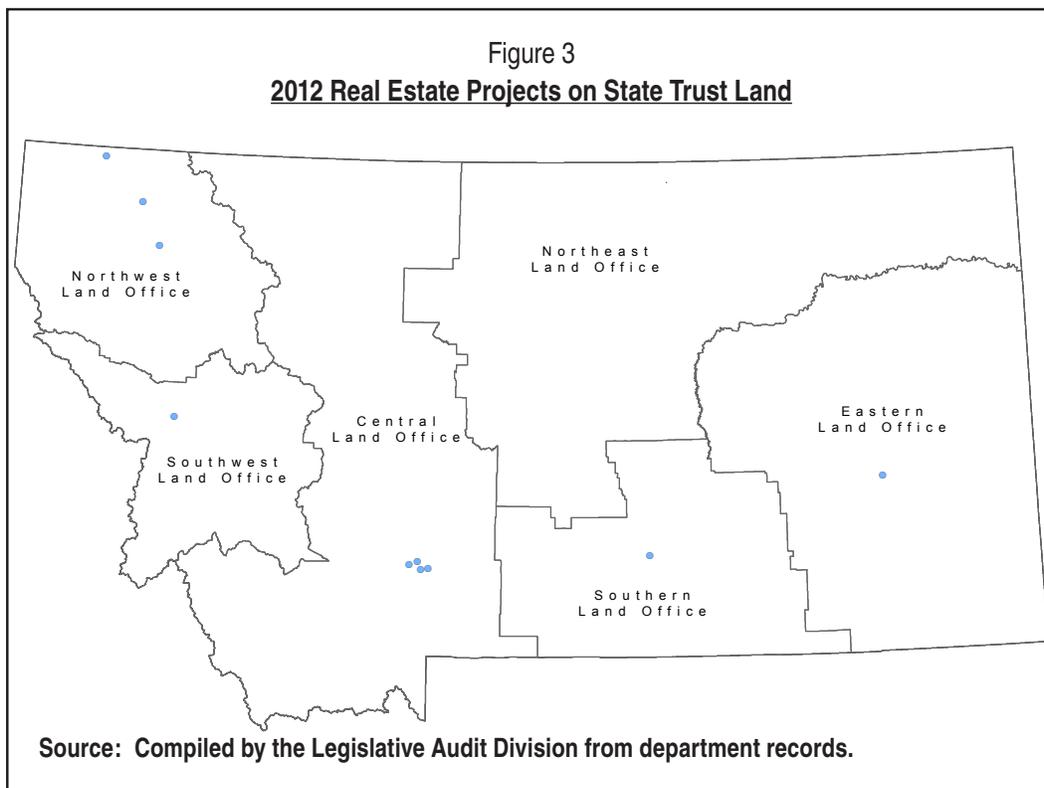
- ◆ **Urban Growth Areas (UGA)** - are defined as trust lands located in an incorporated city or within 4.5 miles of the boundaries of an incorporated city, or within an unincorporated jurisdiction with developed public infrastructure or within 1 mile of such an unincorporated jurisdiction.
- ◆ **Rural** – areas are defined as those areas outside of the UGA parameter as described above. Development in rural areas will include commercial resorts, development for public purposes such as sewer or water, natural resource based development, and conservation opportunities.

According to the plan, project selection is based in part on the two location criteria, with urban the highest priority and rural the lowest priority. The purpose of these location criteria serve as an initial point of identification for potential real estate projects. Any

tract of trust land which may fall within these two location criteria would still need to be reviewed for suitability, per the evaluation tools, development standards, and selection processes outlined in administrative rules and department policies.

The Department Could More Proactively Identify Commercial Leasing Opportunities

As part of our audit work, we reviewed available documentation for the ten real estate projects located on the department's 2012 Real Estate Project List in order to determine how commercial leasing opportunities are identified, selected, and evaluated. Figure 3 illustrates the location of the ten real estate projects we reviewed from the department's 2012 real estate project list. These projects generally involve a mixture of commercial, industrial, and residential development on state trust lands. For example, there is a 285 acre real estate project near the Billings' airport on state trust land, which is a mixed use development with proposed commercial leasing and residential sales.

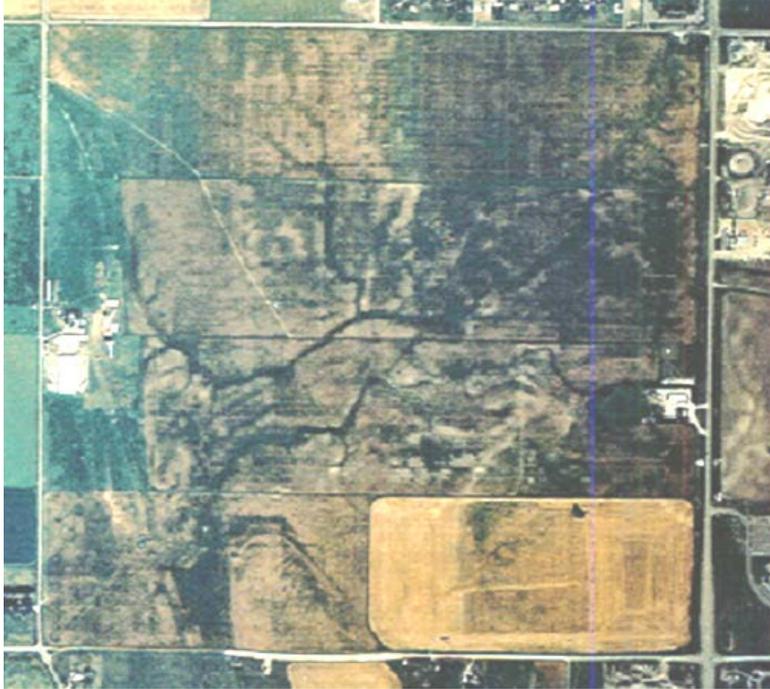


As part of our audit work, we reviewed these projects to determine how projects were identified and if projects are evaluated to determine their suitability. While the outcome of a real estate project may not always be a commercial lease, we noted that 80 percent of those projects included potential commercial development and leasing as a project element. Based on our audit work, we determined while the department has established a process to evaluate the suitability of a trust land parcel for real

estate development and commercial leasing, the initial identification of trust lands as candidates for real estate development is done on an ad hoc basis, with potential parcels primarily identified by external parties. Other states which also establish commercial leases on state trust land more proactively identify commercial leasing opportunities as part of a strategic process. In comparison, commercial leases on Montana trust land are commonly identified by private parties or as part of local government land planning efforts, as opposed to proactive efforts on the part of the department. For example, the department has experienced success with commercial development on a tract of trust land adjacent to the northerly city limits of Kalispell commonly referred to as Section 36. This tract of trust land was initially identified as an opportunity for real estate development as part of a city-county master planning effort initiated by local government in 1996. Realizing that Section 36 was in the direct line of growth for the Kalispell area, in 1999 the department initiated a neighborhood plan to guide land use on Section 36 in concert with the city-county master plan. Subsequently, in 2001 the department prepared an Environmental Impact Statement to analyze alternative plans for Section 36. That same year, the department also applied for and received approval to annex Section 36 into the City of Kalispell and apply city zoning classifications to the property. Figure 4 depicts before and after aerial photographs of the development of Section 36 over an approximately 20-year period from 1992 through 2011. As illustrated by Figure 4, in 1992, Section 36 was primarily used for agricultural and grazing purposes. However, in 2011, the uses on Section 36 have changed significantly, with numerous commercial developments. Current commercial leases on the map are denoted by black arrows. As a result of these commercial leases on Section 36, the amount of revenue collected by the department for beneficiaries has increased dramatically from approximately \$1,800 to over \$300,000 annually.

Figure 4
Section 36 Development: 1992 Through 2011

1992



2011



→ Arrows denote locations of current commercial leases.

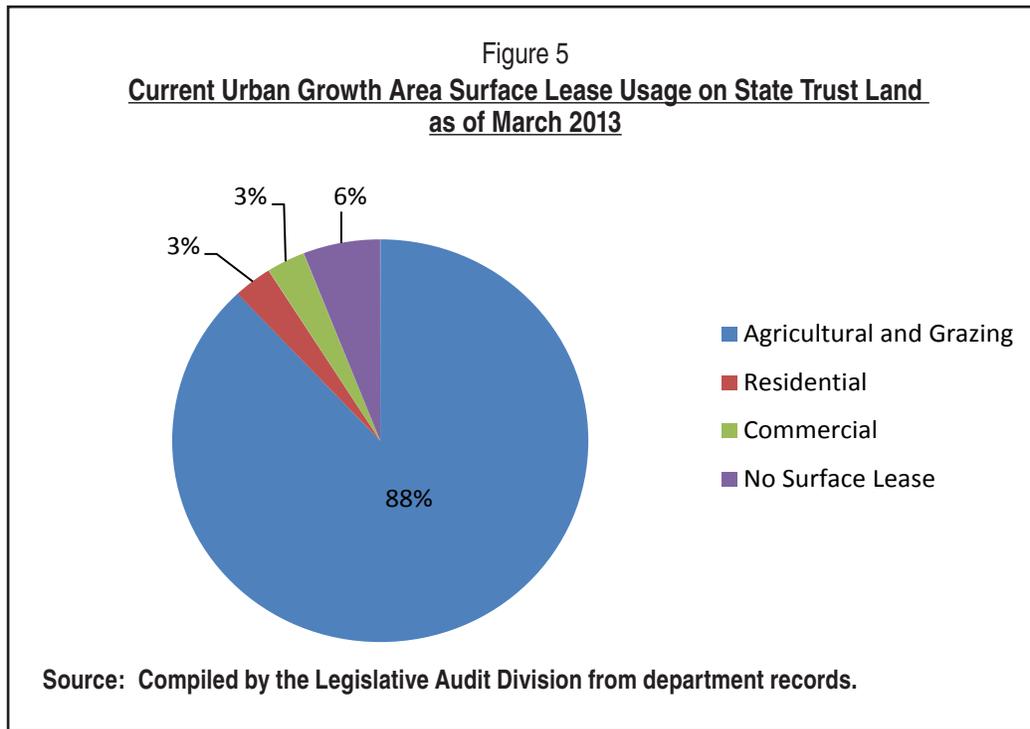
Source: Compiled by the Legislative Audit Division from department records.

While it is positive the department recognized working with the City of Kalispell to develop Section 36 could lead to commercial opportunities, the reason the department began to expend resources on this tract of trust land for commercial development was in response to local government planning efforts. The success the department has experienced on this tract of trust land is not typical and underscores how important it is the department work proactively to identify similar commercial opportunities on a statewide basis. During our audit work, we noted the City of Missoula implemented a developer's showcase in 2013 to attract land developers to the community to market the development of public and private land within city limits, including commercial development. As part of this showcase, the City identified developers they had successfully worked with in the past and invited them to the city to showcase land development opportunities, including introducing these developers to local land planning resources such as bankers, city planners, and architects. However, a tract of trust land which the department has been trying to lease commercially within Missoula for nearly 15 years was not included as part of the showcase event, as City officials were unaware of the existence of local trust land for commercial use. Had the department participated in this showcase event, they may have been able to generate interest in commercial leasing on trust land within the City. As the department continues to move forward, this may be a strategy they could employ to more actively identify and market potential tracts of trust land for commercial development.

Trust Lands With Commercial Potential May Not Be Developed

Without proactively identifying tracts for commercial leases on state trust land, the department is not developing trust lands with potential for commercial development in the best interest of trust beneficiaries. As part of our audit work, we obtained available geographic data for current surface leasing agreements (agricultural, grazing, residential, and commercial) on state trust lands within Urban Growth Areas (UGAs). UGAs are trust lands located in an incorporated city or within 4.5 miles of the borders of an incorporated city. UGAs are the areas with the highest potential for commercial leasing opportunities. We conducted a geospatial analysis to determine what state trust lands are located within UGAs, what types of lease agreements currently exist within those regions, and if the department is actively identifying commercial leases on trust land. Our analysis found the department has conducted limited commercial leasing in these areas. As part of our analysis, we determined there are currently 129 UGAs in the state, covering a total of 7,378,493 acres (see appendix A). Within those 129 UGAs, we determined there are 1,347 surface tracts of trust land, with a total acreage of 435,107. Figure 5 illustrates the current surface lease usages on state trust land tracts within those 129 UGAs as of March 2013. Based on department data, of those 1,347 surface tracts, 1,183 (83 percent) have agricultural or grazing leases; 38 (3 percent) have

residential leases; 39 (3 percent) have commercial leases; and 87 (6 percent) currently do not have a surface leasing agreement. However, there may be other types of revenue agreements on those tracts, such as timber permitting. Based on our analysis, there are potential opportunities for increased commercial leasing in these areas, which could lead to higher long-term revenues for trust beneficiaries.



As part of our analysis, we chose two UGAs to further illustrate the potential for commercial leasing within those areas. We chose the UGAs surrounding the Kalispell/Whitefish and Glendive areas. Based on our analysis, we determined there are numerous trust land tracts which may present potential commercial leasing opportunities in those areas. For example, in the Kalispell/Whitefish area, there are 80 trust land surface tracts covering over 21,000 acres. Sixteen of those surface tracts have agricultural or grazing leases; twenty-eight of those surface tracts have residential leases; and seven of those tracts have commercial leases. Similarly in the Glendive area, there are nine trust land surface tracts covering over 3,700 acres. Eight of those surface tracts have agricultural or grazing leases. Figures 6 and 7 illustrate all surface trust land tracts within the Glendive and Kalispell/Whitefish UGAs. In addition to illustrating state trust land surface tracts within those areas and current agricultural, grazing, residential, and commercial surface lease agreements on those tracts, the maps also include current Montana cadastral data for private commercial properties in those areas to depict the proximity of private commercial properties to state trust land surface tracts. These private commercial properties illustrate that private entities are engaged in commercial leasing activities near state trust land tracts with potential for

commercial leasing. Tracts of trust land without a current surface leasing agreement are denoted by the color yellow. While there may not be a current leasing agreement on those tracts, there may be other types of agreements on those tracts, such a timber permitting. The tracts of trust land identified in our analysis represent potential tracts of trust land for commercial development located within UGAs. Any tract of trust land located within a UGA would need to be reviewed for suitability, in accordance with the development standards and selection process outlined in administrative rules and department policies. Not all parcels will be suitable candidates for commercial leasing opportunities, due to factors such as topography, floodplains, water rights, access, wildfire hazards, or the proximity to community infrastructure and utilities.

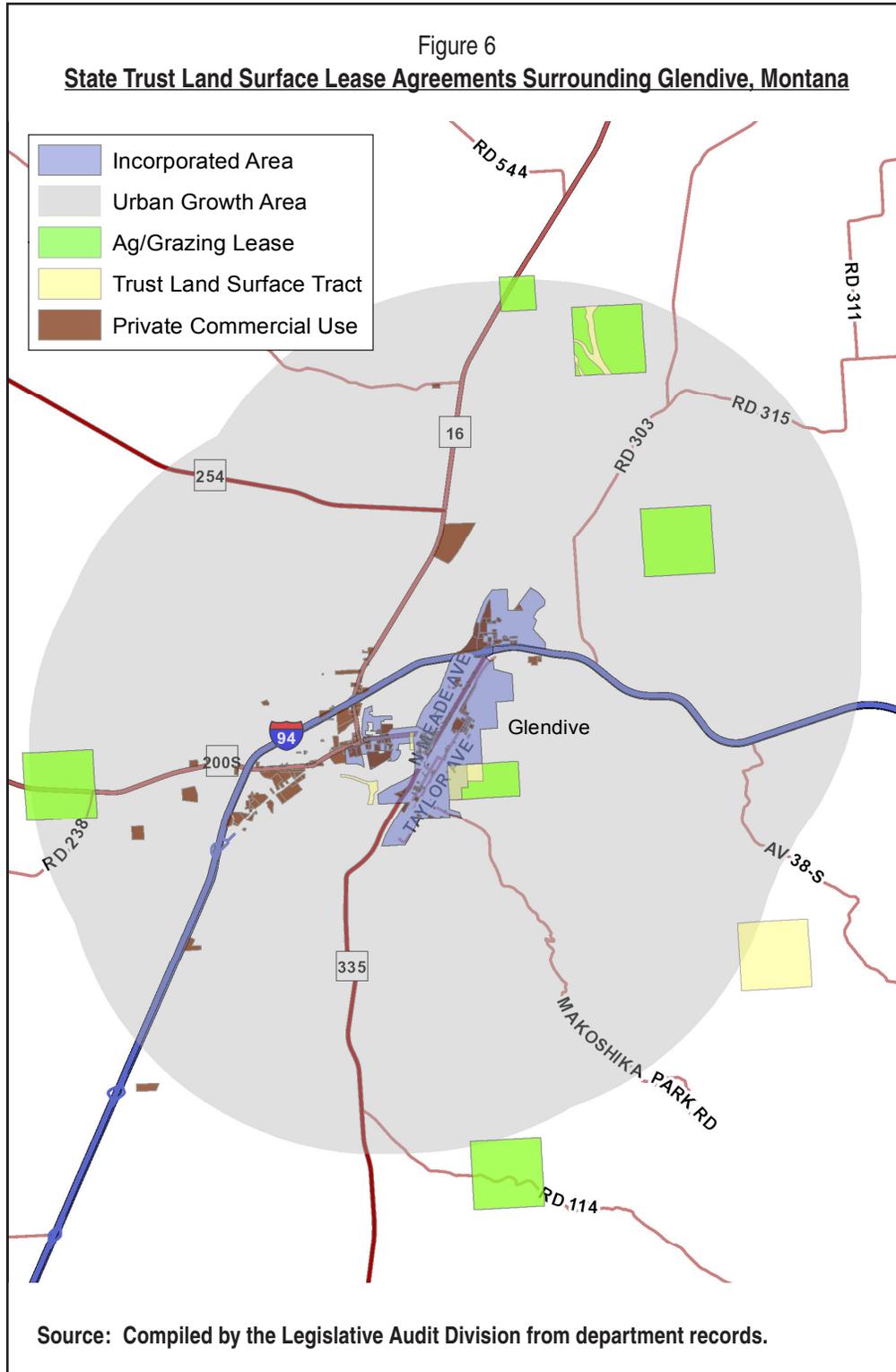
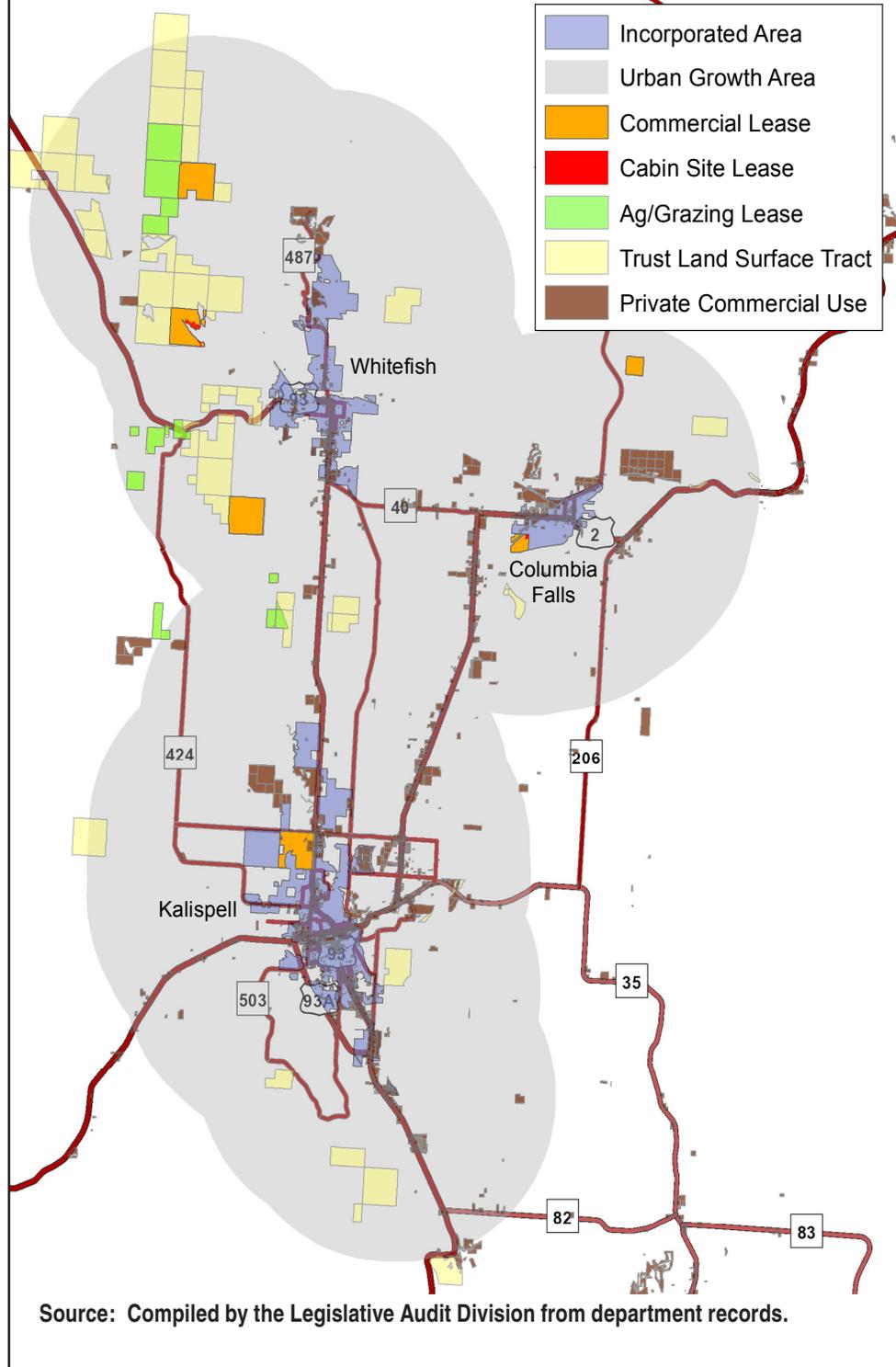


Figure 7
**State Trust Land Surface Lease Agreements
Surrounding Kalispell and Whitefish, Montana**



What is in the Best Interest of Trust Beneficiaries?

There are numerous tracts located within UGAs statewide which may represent potential locations for commercial leasing on state trust lands to maximize revenues for trust beneficiaries. While revenues for other types of leasing activities such as agricultural or grazing are currently much higher than commercial leasing revenues due to overall volume, commercial leasing represents an untapped opportunity for the department to proactively pursue in a way that is not applicable to these other leasing activities. In fact, the department generally sells low producing grazing parcels of trust land in favor of acquiring tracts of property which will produce greater revenue for trust beneficiaries. While it is not possible to speculate exactly how many of these tracts would be suitable for commercial leasing or how much revenue could be earned in those undeveloped areas, it is possible to show the potential increases in revenue that could occur. For example, the majority of undeveloped trust land tracts located within UGAs currently have agricultural and grazing leases. There is potential these tracts could be further developed as commercial leases to enhance revenue for these trust lands. In order to provide some context, the following represents examples of before and after revenue for commercial leases which were formerly agricultural or grazing leases.

- ◆ In northwestern Montana, north of Kalispell, approximately 60 acres have been developed into commercial leases to date. Prior to commercial leases, the trust land generated revenue through crop production lease agreements. According to department data, those 60 acres generated approximately \$1,800 annually for trust beneficiaries through crop production revenue. In 2012, those 60 acres generated over \$300,000 through commercial leasing.
- ◆ In central Montana near Lewistown, a wind farm was developed on 640 acres of trust land. Prior to a commercial lease, the annual grazing revenue on this tract generated approximately \$800 annually for trust beneficiaries. In 2012, this tract generated nearly \$60,000 through commercial leasing.

The Department Should Proactively Identify Commercial Leasing Opportunities

According to department staff, while the REMP establishes location criteria, there is no process in place to proactively identify locations for potential commercial leases on state trust land. They indicated this occurs for a number of reasons, including the fact commercial leasing is just one of many responsibilities related to trust land management. They also indicated that until an external party expresses interest in commercial development on a piece of trust land, there is no point in the department expending any kind of resources to identify and evaluate a tract of trust land for potential commercial development. In addition, they indicate they do not want to displace grazing lease holders without outside interest in a tract. However, the

department has a constitutional obligation to maximize revenue for trust beneficiaries. Department staff also indicated that external market forces and staff attrition have impacted their ability to proactively identify commercial leasing opportunities.

Department staff also cited a general lack of resources and expertise on the part of the department to actively pursue commercial development. However, §77-1-905 (3), MCA, states the department may contract with realtors, property managers, surveyors, legal counsel, or lease administrators to administer a commercial lease, either singly or in common with other leases, or to provide assistance to the department in the administration of commercial leases. In addition, state law permits the department to use administrative funds to manage trust lands. Section 77-1-108, MCA, establishes a trust land administration account available to the department to pay the costs of administering state trust lands. Per state law, appropriations from the account for each fiscal year may not exceed an amount equal to 25 percent of the distributable revenue generated in the fiscal year completed prior to the legislative session that will appropriate money for the next biennium. According to data provided by the department, the distributable revenue for fiscal year 2010 was \$146,163,046. Based on state law, for fiscal year 2012 the department may by legislative appropriation ask for up to 25 percent or \$36,540,761 of the distributable revenue from fiscal year 2010. In fiscal year 2012, the department asked for an appropriation of \$11,531,601 or approximately eight percent of the distributable revenue from fiscal year 2010. Department staff indicate that an increase in administrative costs results in a short-term decrease of revenue for beneficiaries. However, without proactively pursuing commercial leasing on state trust lands, the department is not maximizing long-term revenue opportunities for the beneficiaries. The department could ask for increased legislative appropriations to obtain needed resources to further develop commercial leasing on state trust lands and increase the long-term revenue accruing to beneficiaries.

Overall, audit work found the department could more proactively identify commercial leasing on state trust lands. In addition, there are no targets or objectives for commercial development within the department, nor are there any time lines associated with existing projects. While the department established an asset management plan for surface trust land activities in 2010, this plan is a conceptual document that does not specifically define how commercial leasing fits into the broader management of state trust lands. Past audit work reviewed this plan and while the department indicated several times it is in the process of improving the plan, the plan has not changed since it was released in 2010.

Other States Actively Identify Commercial Leasing Opportunities on Trust Lands

Other states have more clearly incorporated active identification of real estate development on trust lands. For example, in Utah, real estate development is targeted within urban areas or areas in close proximity to urban areas, which are expected to become urban within the next 20 to 30 years. Utah typically targets trust land for real estate development which is already surrounded by established infrastructure, after which they establish a master planning document which guides how the development will proceed over the course of several decades. Similarly, Arizona targets real estate development in urban areas. They also establish long-range development plans for trust lands in urban areas, with specific milestones that align expected urban growth with development opportunities. Montana could develop similar practices when identifying and developing commercial leasing opportunities on state trust lands.

RECOMMENDATION #1

We recommend the Department of Natural Resources and Conservation proactively identify and develop commercial leases on state trust land by establishing:

- A. *Identification and development goals, including long-term targets and milestones for commercial leasing activities.*
 - B. *A resource allocation plan to enhance long-term revenue for trust land beneficiaries.*
-

Chapter IV – Commercial Lease Issuance, Monitoring, And Documentation

Introduction

Our third audit objective examined if the Department of Natural Resources and Conservation (department) complies with state law, administrative rules, and department policies and procedures for issuing and monitoring commercial leases on state trust land. The department's Real Estate Management Bureau (REMB) is responsible for issuing and monitoring commercial leases. While commercial leasing is centrally located and administered in Helena with the REMB, field staff within each of the department's six area land offices generally conduct issuance and monitoring activities. Over the course of our work, we concluded the department does not comply with state law and administrative rules for commercial leasing issuance activities. The department has limited policies and procedures in place to promote consistency for activities between each of its six area land offices. We concluded that management controls for documenting commercial leasing activities are limited. The department should improve process consistency and compliance with state law, administrative rules, and/or establish policies and procedures related to issuing, monitoring, and documenting commercial leasing activities. This chapter discusses our findings, conclusions, and recommendations related to improving processes consistency, compliance with applicable laws, rules, and policies, and management controls for documenting commercial leasing activities.

Appraisal Requirements For Commercial Leases

As part of establishing an annual rental for a commercial lease, the department is required by state law and administrative rules to obtain a land appraisal. The following bullets outline appraisal requirements for commercial leases:

- ◆ Section 77-1-905(2), MCA, indicates the department will specify in any commercial lease an annual rental equal to the full market rental value of the land. State law establishes an annual minimum rental rate for commercial leases based on the appraised value of the land.
- ◆ Administrative rules indicate that pursuant to state law the department will set the minimum annual rent for any commercial lease to obtain the full market value of that lease. Such rental shall be at a rate not less than the product of the appraised value of the land multiplied by a rate that is 2 percentage points a year less than the current federally-guaranteed, annual, 20-year bond rate provided by the Montana Board of Investments.

For example, if a tract were appraised for \$100,000 and the 20-year bond rate were 5 percent then the annual minimum rental rate could not be lower than 3 percent

or \$3,000 annually (or 2 percentage points a year less than the bond rate). Per ARM 36.25.917 (2), the content of an appraisal must include state-owned improvements and comparable sales for like-properties. Per this administrative rule, the department may conduct an appraisal internally or contract with a Montana-licensed certified general appraiser. The department is required to review and approve an appraisal conducted by a contract appraiser. Furthermore, the department's scope of work for contracted appraisals indicates the purpose of an appraisal is to make a determination of the compensation to be paid for a lease. The scope outlines assignment conditions for the appraisal, including conforming to appraisal standards, physically inspecting the subject property, and including state-owned improvements in the valuation. This scope of work indicates that any appraisal is to conform to the latest edition of the Uniform Standards of Professional Appraisal Practice.

Commercial Leases Are Not Always Appraised

As part of our audit work, we reviewed 21 commercial leases established by the department since July of 2003 when state law regarding commercial leases took effect. We determined the department did not appraise 10 (48 percent) of those commercial leases, as prescribed by state law and administrative rules. The combined annual rental for these 10 leases totaled nearly \$95,000 in fiscal year 2012. In our work, we noted the department did not conduct an appraisal, conducted an incomplete appraisal, or established an annual rental based on an alternative valuation methodology, including timber stumpage rates, power generation, and fee schedules for similar activities on federal lands. The following are examples of incomplete appraisals and alternative valuation methodologies used by the department to establish annual rental rates for commercial leases:

- ◆ The appraisal for a federal post office on a one-acre tract consisted of an e-mail from the department's internal appraiser providing a range of values for which there was no basis or property comparables.
- ◆ The appraisal for a federal office building on a four-acre tract consisted of a one-page market review of local market property listings conducted by the department's internal appraiser. The review indicated that a comparables inspection was not completed and the review did not constitute an appraisal.
- ◆ Annual rentals for four commercial leases housing communications sites were established via a federal fee schedule for similar activities on federal land with no consideration of property comparables.

Are Beneficiaries Receiving Full Market Value?

Without an appraisal, not only is the department out of compliance with state law and administrative rules, more importantly, they are unable to demonstrate they are obtaining full market value and maximizing long-term revenue for trust beneficiaries. As a result of conducting incomplete appraisals or using alternative valuation

methodologies, annual rental rates are inappropriately established for commercial leases. For example, the department has adopted a practice to value communication sites on state trust land by following a federal fee schedule for similar activities conducted on federal lands. This fee schedule takes into consideration the type of communication use such as television, radio, or cellular and provides a tier of fees based on user population. In our work, we noted annual rentals varied widely for similar communication sites. Annual rental rates ranged from approximately \$900 annually to \$7,500 annually. As a result of limited documentation, the department was unable to support how these rental rates were established. In addition, one of the sites also included a revenue sharing agreement, where the lease holder also paid the department 10 percent of any subtenant rental fees on a monthly basis. According to department staff, this practice is not defined in department policy. In another example, the department established the annual rental rate for a wind generation facility based on megawatt production, rather than obtaining an appraisal as the basis for annual rental. These various methods of valuation raise the question as to if the department is consistently making a determination of the full market value of the state trust land for commercial leasing and maximizing long-term revenue for trust beneficiaries, as outlined in state law.

The Department Does Not Believe an Appraisal is Always Needed

Department staff indicated first and foremost state law requires them to obtain a rental equal to the full market rental value of the land. They offered that in some circumstances an appraisal of the tract of trust land would not result in the trust beneficiaries obtaining the full market rental value of the land. For example, for commercial leases with communication sites, due to the small foot print or size of the tract, an appraisal would result in a lower value than using an alternative valuation methodology, such as the federal fee schedule for similar uses on federal land. As a result, they believe it is in the best interest of the beneficiaries to use alternative valuation methodologies to establish annual rentals in some circumstances. However, the department is unable to support if these alternative valuation methods are in the best interest of beneficiaries. In our work, we determined state law and administrative rules require an appraisal be used as the basis for establishing the annual minimum rental rate for a commercial lease on state trust lands. Alternative valuation methods are not permitted.

RECOMMENDATION #2

We recommend the Department of Natural Resources and Conservation:

- A. *Set the annual rental for commercial leases based on the appraised value of the land, or*
 - B. *Seek the statutory authority to establish annual rentals for commercial leases based on alternative valuation methodologies.*
-

Audit Work Found Limited Evidence of Appraisal Reviews

When the department appraises trust land for a commercial lease to determine an annual rental, the department may either conduct an appraisal internally or contract out for an appraiser. Per ARM 36.25.917 (2), the department is required to review and approve an appraisal conducted by a contract appraiser. However, whether conducted internally or by contract, the department should always review a land appraisal to ensure the appraisal valuation is credible and conforms with appraisal standards. We reviewed 21 commercial leases and found appraisal reviews were not conducted for 15 (71 percent) of the leases we reviewed.

Appraisal Valuations Could Be Better Supported

Without an appraisal review, the department is unable to ensure appraisals conform to expectations outlined in administrative rules or the annual rental rate is the highest supportable in the market. In addition, there is no assurance that appraisals comply with appraisal standards or that trust beneficiaries are receiving the highest amount of possible revenue. The department indicated the lack of appraisal reviews we noted during our audit work was a documentation issue and they were unable to locate appraisal reviews as they may have been misfiled. Department staff acknowledged policies or procedures for documenting these appraisal reviews need to be established by the department. It is important for the department to review appraisals to ensure trust beneficiaries are receiving the highest rental supportable in the market.

Other State Agencies Routinely Review Appraisals

Other state agencies routinely appraise or have property appraised to make a determination of value, including reviewing appraisals conducted by outside parties. In our audit work, we reviewed the appraisal review process used by the Montana Department of Transportation's (MDT) Right-of-Way function. We noted that MDT policy requires all appraisals used by the department for federal-aid acquisition purposes be reviewed and approved by a review appraiser prior to the commencement

of negotiations. This appraisal review process is part of the appraisal process that ensures both the property owner and the taxpayer are treated fairly by having properly prepared appraisal reports with credible valuation estimates. The review appraiser determines that the concluded value is the highest price supportable in the market and that the appraisal is made in accordance with the highest professional methods and ethical standards.

RECOMMENDATION #3

We recommend the Department of Natural Resources and Conservation:

- A. *Review and approve land appraisals used to determine annual rentals for commercial leases.*
 - B. *Develop and implement policies and procedures for documenting appraisal reviews for land appraisals.*
-

State Law Requires Request for Proposals to Issue Commercial Leases

Section 77-1-904 (1), MCA, authorizes commercial leasing for a term not to exceed 99 years to the highest and best bidder responding to a department request for proposals (RFP). An RFP is a competitive solicitation by an agency or company interested in the procurement of a commodity or service to potential suppliers to submit a proposal to meet that need. According to department staff, an RFP for a commercial lease on state trust land is not a solicitation for bids to provide goods or services in the traditional sense of procurement. Rather an RFP for a commercial lease on state trust land seeks a land developer's general plan, vision, or concept for commercial development on trust land, and the highest and best rental revenue that might be achieved by implementing that concept. In addition, the department's Real Estate Management Plan (REMP) indicates the department will be proactive in real estate opportunities by employing an RFP process. The RFP requires the department evaluate the economic viability of each proposal, select the best concept, and then negotiate the specific terms of the lease with the land developer. While an RFP for a commercial lease does require a respondent submit a minimum bid based on an appraised value, the RFP is primarily a competitive process to identify the highest and best use of the property. According to department staff, an RFP will not always result in a commercial lease. Often, after protracted lease negotiations with a land developer, it may become apparent a commercial lease is not financially viable.

Commercial Leases Are Issued Through a Noncompetitive Process

The department is not complying with state law when issuing commercial leases. As part of our audit work, we reviewed 21 commercial leases and determined that the department did not use an RFP process to issue the lease for 9 (43 percent) of the leases. Rather than using an RFP, the department directly issued a lease without going through a process to identify the highest and best use of the property. The RFP process provides not only an avenue for submitting a bid on a commercial lease but also a land developer's proposed vision or concept for the tract of trust land that would provide the best financial rate of return for a trust beneficiary. We identified a number of times when the department did not issue an RFP for a commercial lease and engage in a competitive process. The following are examples where a competitive RFP process should have been used when issuing commercial leases.

- ◆ Four commercial leases housing communications sites on state trust land were established without the benefit of an RFP.
- ◆ One commercial lease represented a commercial office property obtained by the department in a land exchange. Subsequent to the exchange, the department leased a portion of the property without going through an RFP process.

It is impossible to speculate what type of commercial leasing opportunity may have occurred on these locations if an RFP had been issued. However, without a competitive process where multiple individuals could have responded to a department solicitation to identify the highest and best use of property, the department has not ensured it is maximizing revenue for trust beneficiaries.

Converting Land Use Licenses to Commercial Leases

During the course of our audit, department staff informed us there are circumstances where they believe an RFP is not required to issue a commercial lease. For example, communication sites which are currently commercial leases on trust land represent converted land use licenses (LUL). In our audit work, we noted several circumstances of converting LULs to leases, including communication sites and a community golf course. A LUL is a short-term temporary use with no permanent surface improvements or facilities. According to department staff the decision to convert these communication sites from a LUL to a lease is a decision that was made internally, to better align the long-term usage of the property to the appropriate type of agreement. The department determined these communications sites were more appropriately handled as commercial leases and made the decision to convert these LUL agreements to leases, as the communication sites contained permanent facilities, such as communication towers and associated infrastructure. During our audit work, department staff

indicated they did not believe in these circumstances it was practical to issue an RFP, because a converted LUL may potentially not present a competitive interest for any other party. However, according to department legal staff, there are no exceptions to the RFP process for commercial leases as outlined in state law.

RECOMMENDATION #4

We recommend the Department of Natural Resources and Conservation consistently issue commercial leases to the highest and best bidder responding to a department request for proposals.

**Department's Request for Proposal
Process Should Be Consistent**

In addition to not always using an RFP process, the manner in which the department issues and awards commercial leasing RFPs is conducted inconsistently. For the 21 commercial leases we reviewed, the department issued an RFP for 12 (57 percent) of the leases. However, we noted a number of inconsistencies in that process, including limited responses, evaluation committee composition, and proposal scoring. For example, we noted the RFPs issued by the department generally only received one response, with a single applicant responding to and being awarded a commercial lease. In addition, while the department will assemble an evaluation committee to review and score RFPs, the composition of that committee varied widely. In one circumstance, we found evidence of only one department staff member reviewing and scoring RFP proposals. It was also unclear who should serve on the evaluation committee. In our work, we noted in some cases only area land staff reviewed and scored proposals; in other cases a combination of area land staff and staff located within the REMB reviewed RFP proposals. Lastly, our review noted in those cases where only one applicant responded to an RFP they were always awarded the lease, regardless of how they scored or the quality of the proposal. In one case, we noted department staff characterized the proposal for a storage unit on trust land as a poor response, with portions of the proposal absent. Nonetheless, the applicant was awarded the commercial lease.

**The Integrity of the Request for Proposals
Process Should Be Maintained**

The inconsistencies discussed above raise questions regarding the integrity of the department's RFP process, including the standards by which proposals are issued,

reviewed, and awarded. For example, while the department characterizes the RFP process as a competitive solicitation to identify the highest and best commercial use to a tract of trust land, our audit work determined that RFPs are often written in a manner to solicit a response for a single use. During audit work, we noted several examples where an RFP was essentially written as a sole source contract, with the intended use of the state trust land tract for the commercial lease explicitly stated in the introduction to the RFP. Similarly, as discussed above, the manner in which RFP proposals are scored raised questions about the integrity of the process. In our audit work, RFPs with a single respondent were issued commercial leases no matter how they scored during the process, raising the question as to what exactly would constitute an acceptable versus unacceptable response. It is important for the department to consistently issue and award commercial leases to ensure the integrity and defensibility of how they make these decisions for state trust land beneficiaries.

The Department Has Not Established Policies and Procedures for Request for Proposals Process

According to department management, they have not developed policies or procedures to guide REMB staff and area land staff in how to conduct the process; however, they have developed a template for the actual RFP document. We reviewed the department's RFP template to determine the level of guidance this document provides for department staff, both in the REMB and to area land staff when issuing commercial leasing RFPs. We determined the department's RFP template does not clearly define the purpose of the RFP or the manner in which proposals are evaluated. The RFP template provides an outline for department staff regarding the context of the RFP, including points allocated for each requirement, but the document does not provide any direction regarding how the department evaluates each of these requirements. Consequently, there is no direction for department staff beyond defining minimum content for a respondent or what constitutes an acceptable versus unacceptable proposal.

State Policy Outlines Requirements for Request for Proposals

While an RFP for commercial leasing is not a solicitation for goods or services in the traditional sense of procurement, the department nonetheless has an obligation to more clearly clarify the RFP process for commercial leasing to ensure transparency and defensibility. State policy provides a model for the RFP process and outlines the fundamental methods and tools used during procurement, including defining the scope of an RFP and the criteria used to evaluate competing proposals. State policy encourages state agencies to contact the State Procurement Bureau when using an RFP. This bureau provides a number of resources and training materials for agencies when using an RFP process, including a manual entitled *Initiating and Navigating the*

Request for Proposal Process. This manual assists agencies in issuing and evaluating RFPs, including defining core requirements, scoring criteria, evaluation committees, and final selection.

RECOMMENDATION #5

We recommend the Department of Natural Resources and Conservation develop and implement policies and procedures for the request for proposals process for commercial leases, including:

- A. *Highest and best use scope,*
 - B. *Evaluation committee composition and responsibilities,*
 - C. *Proposal scoring, and*
 - D. *Final selection.*
-

The Department Could Improve Commercial Lease Monitoring

Once any state agency has signed a contract and the contractor has begun work, it is important to monitor the service provider's performance under the contract to promptly address any problems which may arise. Contract monitoring includes planned, ongoing, or periodic activity that measures and ensures contractor compliance with the terms, conditions, and requirements of a contract. While a contractor has the responsibility to perform under the terms of the contract, state agencies have the responsibility for reasonable and necessary monitoring of the service provider's performance. According to department staff, there are two types of monitoring activities which can take place on commercial leases, namely financial reviews and physical reviews. Financial reviews are reviews conducted to review and adjust the annual rental to ensure the department is securing a fair return on the leased property. Physical reviews are reviews to ensure the physical appearance of the property aligns with the terms of the lease. As part of our audit work, we reviewed 23 leases to assess and determine how the department monitors commercial leases. Our work determined that 13 lease files (57 percent) did not contain documentation of a financial review within the past ten years; and 20 files (87 percent) did not contain evidence of a physical review within the past ten years.

The Department Does Not Ensure Lease Compliance

As a result of the department not routinely monitoring commercial leases, the department is not ensuring that lease holders are in compliance with the terms, conditions, and requirements of a commercial lease. Consequently, the department may be placing

trust lands at risk and not protecting the interests of trust beneficiaries. For example, commercial leases on state trust land require lease holders be in compliance with environmental laws in Montana. We reviewed a commercial lease for a shooting range. Per the department's standard commercial lease template, lease holders are required to comply with all environmental laws regarding toxic or hazardous substances. We reviewed department documentation for a physical review in 2011 on the shooting range and determined there was no consideration of lead contamination or abatement. Lease stipulations for commercial leases also outline the types of insurance required for lease holders over the term of the lease, including liability insurance, property insurance, and worker's compensation insurance. We noted physical reviews of commercial leases do not confirm that lease holders have obtained and maintain appropriate insurance coverage. Similarly, for financial reviews, we determined the department may not be ensuring the trust beneficiaries are receiving a fair financial return on the leased property. For example, we reviewed documentation of an example of an incomplete financial review in 2012. According to available documentation, department staff forgot to complete the scheduled review and postponed it until the following year. The commercial lease in this circumstance was a communication site with a current annual rental of approximately \$1,400.

There Are No Policies or Procedures for Monitoring Commercial Leases

According to department management, they have not developed policies or procedures to guide Helena staff and area land office staff in how to monitor commercial leases. Department management indicated the development of these policies or procedures was the responsibility of staff who have since left the office. Consequently, policies and procedures have not yet been developed. Per department staff, both financial and physical reviews are conducted every five years. However, during the course of our audit work, we determined not all area land office staff are aware of this five-year time line. According to department management, they annually query the database for the date of the last review and use this information to determine which leases are due for a five-year review. For physical monitoring, after staff in Helena have identified which leases are due for a five-year review, they will send a list to the appropriate area land office, which will conduct the reviews as time permits over the course of their other duties. Physical reviews are documented with the form the department uses for conducting physical reviews on residential leases. However, this review form broadly records the physical appearance of the property, and does not have any connection to the stipulations of a commercial lease. In practice, area land office staff are directed to return a completed physical review form to staff in Helena, but this does not always occur. In our work, regarding a physical review, we noted that commercial leases contain language indicating the department has the right to access the property

at a reasonable time in order to assess its condition, but no specific requirements or schedules for physical reviews. According to department staff, the results of physical reviews can lead to corrective action and may impact the renewal of a commercial lease. Similarly, for financial reviews, staff also query the department's trust land data base annually to determine the date of the most recent financial review. Financial reviews are then generally conducted at the discretion of staff.

Overall, department staff reported monitoring commercial leases is a fairly new concept within the department, as compared with more traditional land management activities, such as agricultural or grazing leases. They indicate commercial leases are difficult to administer and they lack the expertise to properly monitor. Department staff recognized they need to develop policies and procedures regarding expectations for monitoring commercial leases. As the department moves forward in developing monitoring for commercial leases, they should keep in mind that state law allows them to use funds from the trust administration account to contract for the management of commercial leases on state trust land. Section 77-1-905 (3), MCA, states they may use these funds to contract with realtors, property managers, surveyors, legal counsel, or lease administrators to administer a commercial lease, either singly or in common with other leases, or to provide assistance to the department in the administration of commercial leases.

State Policy Directs Agencies to Monitor Contracts

According to state policy, state agencies are required to monitor and enforce contract obligations and any issues that may arise. The policy states each state agency should have a system in place to monitor its contracts. The purpose of such a system is to monitor the contract period, record important contract information, and ensure compliance with the terms, conditions, and requirements of a contract. Per the policy, state agencies need to place emphasis on effective contract administration. Agencies need to regularly monitor contract performance since early detection and correction of nonperformance is critical for the success of the contract. The policy outlines several key questions for agency personnel to consider for effective contract monitoring and enforcement, including are payments being made according to contract provisions; are problems being addressed as soon as they are identified; does the contractor understand what is expected; and is the state meeting its contractual obligations.

RECOMMENDATION #6

We recommend the Department of Natural Resources and Conservation develop and implement policies and procedures for the financial and physical monitoring of commercial leases, including content relative to lease stipulations, monitoring frequency, and enforcement.

Commercial Leasing Process Needs Better Documentation

In addition to a lack of compliance and consistency regarding the above activities, we noted limited documentation for all aspects for commercial leasing. The department has not established policies or procedures which outline how to document commercial leasing activities. We also noted that documentation—when available—was located in multiple locations between Helena and each of the six area land offices. The fact that the documentation for commercial leases was located in department area land offices is not an issue. However, department staff were generally unable to provide us supporting documentation because they did not have a clear idea of how an activity should be documented or where documentation should be located. Examples of limited documentation for commercial leasing activities include:

- ◆ The department does not maintain information to track the status of real estate project development, including commercial leases.
- ◆ There was no evidence of an appraisal for 10 (48 percent) or of an appraisal review for 15 (76 percent) of the commercial leases files we reviewed.
- ◆ There was missing or incomplete documentation for 21 (100 percent) of the RFP files we reviewed.
- ◆ There was no evidence of lease monitoring for 11 (48 percent) of the commercial lease files we reviewed.

During the audit, department staff routinely stressed they were conducting commercial leasing activities in compliance with state law. However, due to limited documentation, the department was generally unable to support how commercial leases are identified, issued, evaluated and awarded, valued and rental rates established, and monitored to ensure compliance with applicable laws, administrative rules, and department policies.

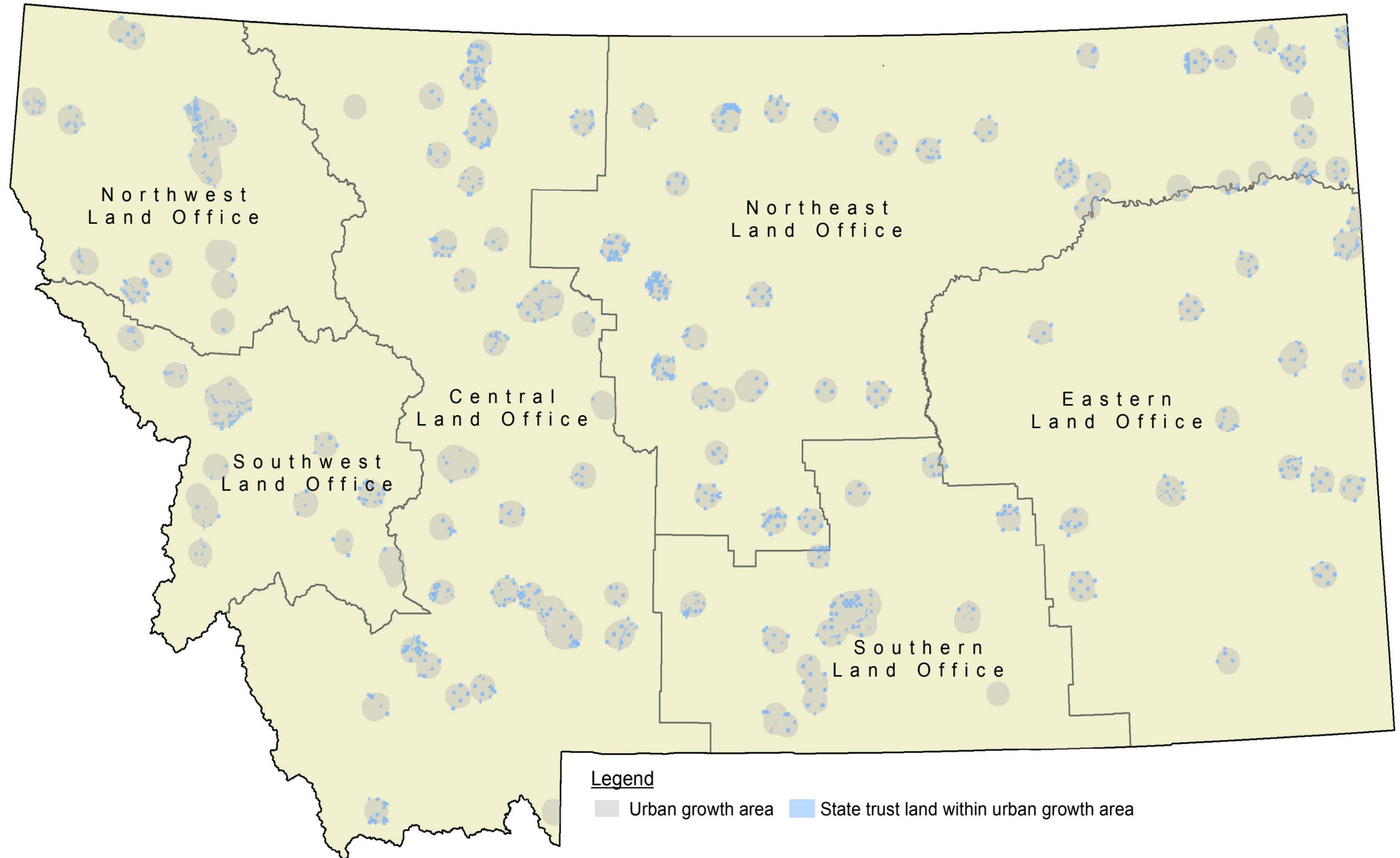
State Policy Directs Agencies to Establish Management Controls

According to state policy, management is responsible for establishing and maintaining agency management controls. These controls promote accountability within an organization and provide a reasonable assurance that what is expected to happen will

actually happen. Operating information is needed throughout an agency to determine if it is achieving all of its objectives and whether the agency is in compliance with requirements under various laws and regulations. The department has not developed a deliberate set of policies and procedures to document those commercial leasing activities to ensure they are being conducted in compliance with applicable requirements.

RECOMMENDATION #7

We recommend the Department of Natural Resources and Conservation develop and implement documentation policies and procedures for real estate projects and commercial leasing activities.



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

DEPARTMENT OF
NATURAL RESOURCES
AND CONSERVATION

DEPARTMENT RESPONSE

DEPARTMENT OF NATURAL RESOURCES
AND CONSERVATION

B-1

Trust Land Management Division



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RE: Response to Recommendations in Performance Audit of Commercial Leasing on State Trust Lands

Dear Ms. Hunthausen,

Below are the Department's responses to the seven recommendations made in the audit report on commercial leasing on state trust lands.

Recommendation #1

We recommend the Department of Natural Resources and Conservation proactively identify and develop commercial leases on state trust land by establishing:

- A. Identification and development goals, including long-term targets and milestones for commercial leasing activities.
- B. A resource allocation plan to enhance long-term revenue for trust land beneficiaries.

Department's Response to Recommendation #1:

Concur

The Real Estate Management Plan (REMP) governs real estate activities and projects on state trust lands. The REMP is the Department's statewide plan for real estate projects and activities that include far more than commercial leases to maximize revenue to trust beneficiaries. While commercial leases are an effective way to maximize revenues, other activities such as land sales and land banking, land exchanges, issuance of easements, and issuance of land use licenses are other appropriate methods under the plan to maximize revenues.

The audit report suggests that commercial leasing activities should have a timeline that is determined and controlled by the Department. From the Final Real Estate Management Programmatic Environmental Impact Statement, Record of Decision, Page 29 "*The REMB plan needs to be dynamic in that this is a land use plan and implementation is affected by outside market forces, local, and state regulations and internally by legislation, Land Board policies, and funding. Identification and implementation of projects is typically a multi-year process. Land use projects could occur gradually, in spurts, or a combination of both.*" The recent

economic recession has demonstrated that when there is a lack of demand for commercial lease properties in the market, lease activity subsides. When the economy improves, as it has recently, leasing activity increases.

Realizing the potential timeframes and expense in real estate development the department has chosen to take a targeted approach, keeping aim on projects that have the greatest potential for increased revenue, instead of a shotgun approach of trying to identify all parcels with any potential for development. The Department has begun to analyze all trust land parcels statewide for real estate development potential, using a GIS based analysis tool. The Development Economic Site Index (DESI) project will analyze all trust lands thorough a coarse filter process to identify those parcels with the highest potential for development. Further review of parcels with high index rating will be needed to further filter parcels with development potential. The Departments goal is to analyze parcels with development potential indicated by DESI index of 80 or higher, by July 1, 2014.

The Department will also be finalizing its updated Asset Management Plan by July 1, 2014; the Asset Management Plan will provide direction on long term planning and goals for the trust lands portfolio. The Real Estate Management Bureau will incorporate long-term project identification and development goals, including targets and milestones for commercial leasing activities in its annual Project Identification Team (PIT) meeting in May of 2014.

Allocation of additional revenues to the Trust Administration Account to support commercial lease development projects would require an appropriation from the legislature, and would divert revenues that would be distributed to trust beneficiaries. In light of land development and leasing projects being typically a multi-year process; and land use projects could occur gradually, in spurts, or a combination of both, it is not prudent to divert trust revenues to where there is no market demand.

Recommendation #2

We recommend the Department of Natural Resources and Conservation:

- A. Set the annual rental for commercial leases based on the appraised value of the land, or
- B. Seek the statutory authority to establish annual rentals for commercial leases based on alternative valuation methodologies.

Department's Response to Recommendation #2:

Conditionally Concur

The Department of Natural Resources and Conservation does set the minimum annual rental for commercial leases **not less than the calculated rate specified in 77-1-905(2), MCA.**

The Montana Constitution, Article X requires **full market value** for any use of an interest in state trust lands.

ARM 36.25.915 specifies, pursuant to 77-1-905(2), MCA, the department will set the minimum annual rent for any commercial lease to obtain the full market value of that lease. Such rental shall be at a rate not less than the product of the appraised value of the land multiplied by a rate

that is two percentage points a year less than the current federally-guaranteed, annual, 20-year bond rate provided by the Montana Board of Investments commercial loan rate sheet.

ARM 36.25.917 specifies the appraisal of land prior to lease or easement. (1) The value of a parcel under consideration for lease or issuance of an easement shall be determined through an appraisal or limited valuation.

(2) An appraisal must include state-owned improvements in the valuation and use comparable sales for like-properties. The department may conduct an appraisal or appraisal update; or the department may contract with a Montana-licensed certified general appraiser. The department shall review and approve an appraisal or appraisal update conducted by a contract appraiser.

- (3) A limited valuation is an estimation of value through other means which may include:
- (a) the department's fee schedule;
 - (b) a survey of real estate appraisers, local tax assessors, or local realtors; or
 - (c) an evaluation of local rents or local market fees.

The Land Board in adopting ARM 36.25.917 has empowered the department to achieve full market rent by use of a limited valuation when an appraisal of the land by a contract appraiser will not establish full market rents, and may not be the best use of trust administration funds. In using other market rent indicators such as the Bureau of Land Management fee schedule for communication sites, or a royalty payment based on electricity generated by wind turbines or hydro power plants, the Department is ensuring full market value rents, instead of charging a rent based on a relatively low land value.

The Department does agree that it will implement procedures by July 1, 2014; to provide improved documentation as to why a limited valuation or other market fee schedules were used, instead of an appraised land value, to establish full market rent. The documentation will show the benefit to the trust of using a limited valuation or other market fee schedule over an appraised land value, to establish full market rent.

Recommendation #3

We recommend the Department of Natural Resources and Conservation:

- A. Review and approve land appraisals used to determine annual rentals for commercial leases.
- B. Develop and implement policies and procedures for documenting appraisal reviews for land appraisals.

Department's Response to Recommendation #3:

Concur

The Department does review contracted appraisals and writes a review report accepting the appraisals. Of the 21 commercial leases reviewed, some had lease rates set through limited valuations, done by Department staff using local market information, as allowed by ARM 36.25.917. Any contracted appraisals for which the Department did not provide appraisal review reports, was due to staff not being able to readily locate the review reports.

Between May 2012 and October 2012, the three Real Estate Management Bureau staff that had worked on developing the Real Estate Management Plan, and had overseen the commercial leasing program for the Bureau, left the department. Lack of documentation on record keeping for the commercial leasing process hindered remaining bureau staff's ability to locate some commercial leasing documents, including some appraisal reviews. Based on that experience, the Bureau agrees that procedures need to be developed to formalize when and how appraisal reviews will be done, and how appraisals and appraisal review documents will be stored and made readily retrievable. The Department's goal is to have those procedures developed by July 1, 2014.

Recommendation #4

We recommend the Department of Natural Resources and Conservation consistently issue commercial leases to the highest and best bidder responding to a Department request for proposals.

Department's Response to Recommendation #4:

Conditionally Concur

The Department does use the Request for Proposal Process for issuing new commercial leases to the highest and best bidder responding to a Department request for proposals. There are instances when leases are acquired under a land exchange or acquisition agreement, or converted from land use licenses, where issuance of a request for proposal is not appropriate, as an agreement is already in place.

The Department does agree that it will implement procedures to document why a lease was issued without the request for proposal process, and how the lease achieves full market rent. The Department's goal is to have procedures developed by July 1, 2014.

The Department will continue to not use the RFP process where conversion of a land use license to a lease, authorized under ARM 36.25.115; or accepting a current lessee under a land exchange or acquisition agreement; is in the best interest of the trust beneficiaries and consistent with the Land Board's constitutional fiduciary duty of attaining full market value.

Recommendation #5

We recommend the Department of Natural Resources and Conservation develop and implement policies and procedures for the request for proposals process for commercial leases, including;

- A. Highest and best use scope,
- B. Evaluation committee composition and responsibilities,
- C. Proposal scoring, and
- D. Final selection.

Department's Response to Recommendation #5:

Concur

The Department will develop and implement more thorough procedures to ensure the request for proposal process for new commercial leases is completed in a thorough and consistent manner, with proper documentation of core requirements for proposals, evaluation committee

composition and responsibilities, proposal scoring, and final selection of a lessee. The Department's goal is to have those procedures developed by July 1, 2014.

The Department will continue to not use the RFP process where conversion of a land use license to a lease, authorized under ARM 36.25.115; or accepting a current lessee under a land exchange or acquisition agreement; is in the best interest of the trust beneficiaries and consistent with the Land Board's constitutional fiduciary duty of attaining full market value. The Department will implement procedures to document why a lease was issued without the request for proposal process, and how the lease achieves full market rent. The Department's goal is to have procedures developed by July 1, 2014.

Recommendation #6

We recommend the Department of Natural Resources and Conservation develop and implement policies and procedures for the financial and physical monitoring of commercial leases, including content relative to lease stipulations, monitoring frequency, and enforcement.

Department's Response to Recommendation #6: **Concur**

The Department will develop and implement more thorough procedures for the financial and physical monitoring of commercial leases. The procedures that will be developed will include process and forms that are specific to the type of property being reviewed, include photos of the property being reviewed, and outline corrective or enforcement actions to be taken if a review indicates non compliance. The Department's goal is to have procedures developed by July 1, 2014.

Recommendation #7

We recommend the Department of Natural Resources and Conservation develop and implement documentation policies and procedures for real estate projects and commercial leasing activities.

Department's Response to Recommendation #7: **Concur**

The Real Estate Management Plan (REMP) governs real estate activities and projects on state trust lands. The REMP is the Department's statewide plan for real estate projects and activities that include commercial leases to maximize revenue to trust beneficiaries. The Department will develop and implement more thorough documentation procedures for real estate projects and commercial leasing activities, which provide more detail on implementing actions under the REMP. The Department's goal is to have procedures developed by July 1, 2014.

As previously mentioned, between May 2012 and October 2012, the three Real Estate Management Bureau staff that had worked on developing the Real Estate Management Plan, and had overseen the commercial leasing program for the Bureau, left the department. Lack of documentation on record keeping for the commercial leasing process hindered remaining bureau staff's ability to locate some commercial leasing documents, including project tracking documents, appraisals and reviews, request for proposal documents, and lease monitoring

documents. Based on that experience, the Bureau agrees that procedures need to be developed to formalize where and how lease documents will be stored and made readily retrievable.

In response to feedback received from auditors, during the audit process, the Bureau is already implementing a checklist process for ensuring commercial lease documents are completed and retained in lease files, in electronic or hard copy format. The Bureau is conducting a review of all commercial lease files, with the checklist, to attempt to ensure all lease files are complete, and taking action to resolve deficiencies. The Bureau has also started a process of scanning lease documents and linking them to lease management records in the Trust Land Management System (TLMS).

Sincerely,



John E. Tubbs, Director
Montana Department of Natural Resources and Conservation