

**REPORT
HIGHLIGHTS**
PERFORMANCE AUDIT

Subject

The State Land Department was established in 1915 to manage state trust lands on behalf of several beneficiaries. Originally granted 10.9 million acres by the Enabling Act and other federal legislation, the Department now manages 9.2 million acres held in trust.

Our Conclusion

The Department should improve its comprehensive state trust land selling and leasing process by establishing time frames or ranges for the process, providing site study information on its Web site as soon as possible, and increasing the number of appraisers on the state-wide contract. The Department should also do more to protect and manage trust land by strengthening lease provisions, and by prioritizing and documenting land inspections.



2007

Department uses comprehensive selling and leasing process, but should further enhance it

The sale of state trust lands is the Department's key strategy for generating revenues for trust beneficiaries such as public schools, colleges, and universities. The Department reports that it manages an estimated 9.2 million acres of state trust land—more than any other Western state. Arizona is also the only state that actively employs an ongoing strategy of selling or leasing its state trust lands through auctions to generate revenues for the trust.

In the past 4 fiscal years, these auctions have generated approximately \$1.6 billion in gross sales.

These auctions also generated nearly \$2 billion in lease revenue that the Department expects to collect over the terms of the leases.

Complex sales/lease process—The Department uses a comprehensive process to help ensure that the sale or lease of state trust land complies with state laws and maximizes revenues. There are five major steps in this process:

Conceptual Planning → Five-Year Disposition Plan → Site Studies → Appraisal → Auction

The first step in this process is conceptual land use planning. Conceptual plans are typically created for large areas of state trust land, such as the 34,742 acres of state trust land in and around the City of Peoria. The planned

area is then divided into smaller parcels for additional planning and sale or lease.

Once the conceptual plan is in place, the Department identifies the parcels planned for sale or lease in the next 5 years and includes them on a Five-Year Disposition Plan (Plan).

Parcels placed on the Plan then receive site studies. The Department typically obtains an environmental assessment, soil studies, and an American Land Title Association survey. In addition, the Department determines whether there are cultural resources on the parcel. The Department obtains various site studies and information for a parcel to properly value, and in some cases increase, the value of a parcel. According to developers, the site studies are needed as they remove some of the risk and uncertainty regarding parcels.

After the studies are completed, the parcels must be appraised. Once the appraisal is completed, the Department submits the parcel to the Board of Appeals for review and approval for sale or lease.

Land Auctions		
Fiscal Year	Auctions	Gross Sales (In Millions)
2004	24	\$ 310.6
2005	17	254.5
2006	21	544.3
2007	<u>20</u>	<u>\$ 453.7</u>
Total	82	\$1,563.1

Prior to holding an auction, the Department must advertise the sale or lease in a newspaper of general circulation nearest the location of the land to be sold and at the State Capitol for 10 consecutive weeks. The Department also contacts potential buyers such as builders, land developers, and land brokers.



Source: Photo of state trust land sold as part of the Desert Ridge development courtesy of the Arizona State Land Department.

Establish time frames or ranges—According to the Department, it typically takes about 2 years to sell a parcel, but the time varies by parcel. Five parcels that auditors reviewed took between 18 months and 3 years to sell.

Because the Department has not established time frames or ranges for its selling and leasing process, it does not know how long each step of the process should take.

Provide site studies earlier—As explained above, the Department obtains various studies on the parcels. However, it does not make these studies available on its Web site when the studies have been completed. For three parcel files that auditors reviewed, most of the site studies were completed about 4 to 8 weeks before department staff submitted a request to post the studies on the Department's Web site. One site study was

completed 7.5 months before a request was made to post it on the Department's Web site. Additionally, for one parcel, the request to post most of the site studies on the Web site was submitted approximately 10 weeks prior to the auction, which, according to developers, is not enough time to adequately review the studies and the parcel.

Take steps to improve appraisals—Most of the parcels included in the Plan are appraised by appraisers who have contracts with the State. However, of the 35 appraisers on the state-wide contract, the Department reported that only 14 have the qualifications the Department requires to appraise state trust land. In addition, because of the unique quality of some parcels, the Department reported that some of these 14 may not have the necessary expertise. For example, only 10 can perform complex right-of-way appraisals.

The Department has had to use appraisers who do not have a contract with the State to obtain some appraisals. It has also had to use some appraisers despite problems with their previous work. This has resulted in situations where the Department spent additional time and resources to remedy problems with some appraisals, including one appraisal that did not comply with appraisal standards.

Working with the Department of Administration, which is responsible for state-wide procurement, and the Department of Transportation, which manages the State's appraisal contract, to obtain a new or supplemental state-wide appraisal contract and improve communication with the appraiser community could help address the Department's lack of qualified appraisers. Auditors contacted nine appraisers who had registered to provide appraisal services for the State but had never submitted a formal proposal needed to get on the state-wide contract. Six of the nine said they were interested in providing services, but misunderstood the State's contracting process.

Recommendations

The Department should:

- Establish time frames or ranges for each step in the state trust land sale/lease process.
- Provide parcel study information on its Web site as soon as it is available.
- Work with the Departments of Administration and Transportation to increase the number of appraisers on the state-wide contract.

Department should further improve state trust land management

Most state trust lands are leased for various uses, including livestock grazing, agricultural use, and mineral extraction.

Managing these leases is critical to (1) protecting the State from liability, and (2) ensuring the land is properly cared for and, where necessary, properly reclaimed.

Department has improved lease language—The State paid more than \$14.7 million from January 1989 to March 2007 for environmental claims on state trust land. These claims included pesticide contamination and petroleum spills left by lessees on state trust land. Because some of the Department's lessees had insufficient resources to cover the clean-up costs or did not have comprehensive insurance or bonding provisions in their leases, it could not recover these clean-up costs.

Leases as of January 2007

# leases	# acres
1,200 grazing	8,400,000
400 agriculture	173,000
120 mineral	N/A

The Department worked with the State's Risk Management Office to improve its lease language. However, a March 2007 review by

Risk Management identified some additional improvements that could be made in some leases.

Further, few of the Department's special land use permits (SLUPs) and mineral exploration permits have comprehensive insurance or environmental protection provisions. The Department reports using grazing SLUPs rather than longer-term leases near some urban areas to increase flexibility over land use. As of May 2007, the Department reported that it had more than 560 SLUPs, including more than 200 active commercial, 150 grazing, and 40 agricultural SLUPs. It also reported nearly 370 mineral exploration permits as of April 2007.

Critical leases should receive timely inspections

Field inspections involve a thorough review of the condition of the state trust land that is under lease. These inspections identify potential health and safety issues caused by the lessees, such as



Source: Photo courtesy of the Arizona State Land Department.

improper storage of equipment or chemicals, or help to ensure proper reclamation of the land from mining and sand and gravel operations.

Well inspections—The Department has inspected hundreds of wells since fiscal year 2005, but more than 200 high-risk wells remained to be inspected as of January 2007. These wells present a higher risk because of their age, depth, and/or proximity to known environmental sites.

Agricultural leases—The Department also inspects expiring agricultural leases. Part of the purpose of such inspections is to inventory state trust lands that are leased for agricultural purposes and to eventually establish lease rates that reflect the market value of these lands. These inspections provide valuable information about the condition of the land. For example, an October 2006 inspection of one lease revealed more than 100 drums posing an environmental hazard to the land. The Department has required the lessee to remove the drums.



Source: Photo courtesy of the Arizona State Land Department.

Grazing leases—Both the Department and Risk Management noted that grazing leases pose the least environmental risk. Inspections of grazing land permit the Department to make recommendations regarding range improvements, preservation of cultural and archaeological resources, and the effect of rights of way on a lessee.

Mineral leases—Despite conducting other lease inspections, the Department reported that it has not conducted inspections on 382 canceled or expired hard rock and sand and gravel leases. Most of these leases were canceled or expired several years ago. However, inspections are needed to see if the land has been properly reclaimed and to ensure no safety or environmental risks exist.

In addition, the Department reported that it has not been inspecting permits issued for mineral exploration. As of April 2007, the Department reported that it had nearly 370 active permits. Although many of these permits have reclamation bonds, which allow the Department to access bond money if the permittee does not

adequately restore the land, department staff reported that they have been releasing the bonds without ensuring the land has been adequately restored and free of debris.

Risk-based inspections and cross-training of staff—According to the Department, it lacks sufficient staff to conduct inspections. The Department can help address this by focusing inspections on high-risk leases. Risk Management and the Department stated that grazing leases have few risks, while mineral and agricultural leases have higher risks.

The Department should also cross-train inspection staff. For example, range managers could be further trained to assess the adequacy of mineral lease reclamations.

Documenting inspections—Although department staff reported that they perform field inspections, not all inspections are documented. For example, staff reported failing to document a total of 50 agricultural field visits in 2006.

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Recommendations

The Department should:

- Continue to work with Risk Management to improve leases.
- Revise SLUPs and mineral exploration permits to include environmental and insurance provisions.
- Establish a risk-based inspection approach.
- Cross-train staff.
- Document and track all field inspections.