STATE OF NEW MEXICO
OFFICE OF THE STATE AUDITOR

SPECIAL EXAMINATION REPORT
NEW MEXICO STATE LAND OFFICE

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State Auditor
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I. EXECUTIVE SUMMARY

The Commissioner of Public Lands (Commissioner) is the executive officer of the State Land Office (SLO) and is the trustee of New Mexico's trust lands pursuant to the Enabling Act and the Constitution of New Mexico. Revenues from trust lands benefit New Mexico's public schools and other beneficiary institutions. When managing and executing state trust land transactions, the Commissioner has a fiduciary duty to the beneficiaries of the trust. The Commissioner generates revenues for the beneficiaries through the sale, lease, exchange and management of state trust assets. The Commissioner may lease trust lands for various surface and subsurface activities, including grazing, agriculture, and oil and gas drilling. In addition, the Commissioner earns revenues from the sale of state trust lands and through royalties from nonrenewable resource production from state trust lands.

The Commissioner has broad discretion and authority under New Mexico law to manage over approximately 8.5 million acres of surface rights and approximately 13 million acres of mineral rights in New Mexico. Furthermore, revenues generated from the Commissioner's management of state trust lands are in the hundreds of millions of dollars. In 2009, the state trust lands realized total revenues of $536.5 million and the total 2009 distributions to beneficiaries were $566.7 million. Given the Commissioner's paramount duty to the trust and the value of New Mexico's trust lands, the Commissioner and the SLO should maintain and adhere to processes that protect trust beneficiaries and ensure transparency in state trust land transactions. The design and operation of internal controls over state trust land transactions are critical in order to allow the Commissioner, SLO management and SLO employees to prevent or detect transactions that would not be in the best interest of the trust beneficiaries.

The Office of the State Auditor (OSA) performed a special examination of the SLO's processing of state trust land sales, exchanges and planning development leases. The general scope of the OSA's special examination work was to test and evaluate the policies and procedures of the SLO regarding state trust land sales, exchanges and planning and development leases. The scope consisted of audit work related to a population of over 100 state trust land transactions for the time period from January 1, 2002 through March 11, 2010. During our examination we performed procedures related to certain risk areas, including whether transactions may have occurred that did not benefit the trust, whether the SLO had adequate policies and procedures in place to safeguard trust lands and whether the SLO followed those policies and procedures. This special examination report contains findings and risk observations that are the results of our procedures.

Overall, our special examination identified a range of concerning deficiencies in SLO's internal controls that were common among numerous state trust land sales, exchanges and planning and development leases. Our examination also revealed that certain state trust land transactions were not executed in the best interest of the trust or there was no supporting documentation that justified that certain transactions were in the best interest of the trust. In many cases, we found that internal controls which should exist to protect trust beneficiaries were improper, ineffective or completely nonexistent.

In other cases, we found that proper internal controls implemented by the SLO to protect the trust were simply overridden by the Commissioner.

For example, we reviewed several land exchanges in which there was a lack of support for material benefit to the trust. The trust beneficiaries did not appear to be deriving much, if any, benefit from some of the land exchanges, and there may have been a financial loss to the trust as a result of the transactions. Other exchanges executed by the Commissioner did not evidence that the trust received full compensation for the true value for the trust lands exchanged. We noted multiple exchanges where the certified appraised value was not the amount that was reflected in the final transaction.

Related to this issue, we noted multiple exchanges in which SLO staff who are not certified appraisers made changes to appraised acreages and values and did not maintain supporting documentation justifying the changes. Moreover, the sales and planning and development leases tested during our examination lacked financial analyses that comprehensively captured all the significant and pertinent aspects of the transactions. Nearly all of the exchange transactions we reviewed omitted financial analyses that comprehensively captured all the significant and pertinent aspects of the transactions. In certain instances where financial analyses were performed for exchanges, we noted the SLO failed to update the analysis to reflect the final acreage in the transaction. Our test work also revealed numerous deficiencies related to land appraisals. We noted certain instances in which the SLO in-house appraiser found an appraisal contained significant deficiencies, but the in-house appraiser nevertheless accepted the appraisal as adequate. We also noted certain instances where the SLO in-house review rejected the appraisal, but the SLO nonetheless used the appraisal. There were additional instances in which the SLO did not conduct in-house appraisal reviews of appraisals. Finally, the Commissioner also consummated certain exchanges of trust land despite recommendations against the exchanges by the SLO's field reviewers. For those exchanges, we did not observe any documentation justifying why the Commissioner decided the transactions were in the best interest of the trust.

The SLO also has no formal policies or procedures that are used to determine the improvement value credit (IVC) percentage that the Commissioner pays to private developers under planning and development leases. Furthermore, the Commissioner and the SLO did not maintain supporting documentation that justified reimbursement to a private developer for the developer's reasonable project costs incurred in connection with a planning and development lease. From November 2006 through July 2010, payments by the Commissioner to developers as a result of IVCs were more than $15 million of the total proceeds of over $25 million from land sales related to planning and development leases. Without policies and procedures, there is increased risk that the trust may not receive true value for the land if the IVC overpays the developer. Additionally, the appraisal of trust land is a critical tool in calculating the IVC disbursed to a private developer. However, we found instances where the Commissioner determined the value of trust lands by using deficient appraisals or appraisals rejected for use by the SLO's staff. We also noted certain instances in which the SLO did not conduct an in-house appraisal review of an appraisal, but the Commissioner nonetheless used the appraisal to determine the value of the land.

This report also highlights specific land transactions in which the Commissioner did not appear to manage the transaction in the best interest of the trust. These instances include allowing parties to certain transactions to forego delinquent lease payments and penalties and interest on those payments, despite the lessee's contractual obligations and a loss of revenue to the trust. With regard to one land sale, the SLO improperly calculated a private developer's IVC, no appraisal supported the value for which the land was sold and the public bidding process appears to have been circumvented by the Commissioner.

In addition, we discovered a general lack of transparency in certain state trust land transactions. Trust beneficiaries were not properly notified or, in some instances, were misled by the SLO about the fundamental elements of certain transactions. For all trust land sales we reviewed, the SLO failed to notify beneficiary institutions of applications to purchase state trust land as required by law; the SLO only notified beneficiaries after completion of the sale. For certain transactions, the SLO provided untimely notice of the trust land transaction to trust beneficiaries. We reviewed six notices (related to one exchange) the SLO sent almost three years after the transaction was finalized, and the SLO sent another six notices (related to one sale) close to one year after the sale was completed. We also identified beneficiary notices that omitted key elements of a transaction, such as the lease revenue the SLO relinquished upon the sale of trust land. Lastly, we reviewed beneficiary notices that contained misleading language regarding the basic facts involving land sales.

Given the aforementioned deficiencies, this report includes a host of recommendations designed to strengthen internal controls related to state trust land transactions, improve transparency in state trust land transactions and better protect the trust beneficiaries against state trust land transactions that may not be in the best interest of the trust. The Commissioner has a fiduciary responsibility to the beneficiaries of state trust land when determining whether or not certain transactions are in the best interest of the trust. Accordingly, the Commissioner and SLO staff should exact great care when determining the true value of land to ensure that the trust receives at least true value for the trust lands that are conveyed. The SLO should implement controls to ensure the use of objective, reliable and commercially acceptable methods of determining the fair market value of trust lands subject to exchange. The SLO should also maintain documentation regarding any increases or decreases to appraised amounts and quantities of land acreage. SLO employees should not alter the value of land without cause, proper support, or the use of an objective, reliable and commercially acceptable method to determine the true value. Changes to original appraised values and acres should be thoroughly documented in order to properly support and meet the true value definition of the lands being exchanged.

Additionally, we recommend that the SLO perform financial analyses on all proposed transactions to ensure that all exchanges, sales and planning and development leases executed by the Commissioner are in the benefit of the trust. The financial analyses should comprehensively capture all the significant and pertinent aspects of the proposed transactions. Financial analyses would also promote transparency and public access to information regarding the management of state trust lands. The Commissioner

should also ensure the trust is fully compensated for the sale or exchange of trust lands by using acceptable and appropriate appraisals to determine the true value of the lands. In-house appraisal reviews and field reviews should be used consistently as one of the key components of SLO analyses of potential land transactions, not only when they support the transaction. If an in-house review rejects an appraisal for use, another appraisal of the land should be conducted and used to determine the land's true value. Furthermore, if an in-house review or field review or other division feedback disagrees with the transaction, there should be documentation to support how and why the transaction proceeded, including explanations that address any adverse reviews.

The SLO should also implement formal policies and procedures to determine the IVC percentage disbursed to a developer, particularly when such a high percentage of sales proceeds are paid to the private developers and not the trust beneficiaries. The Commissioner's lack of formal policies and procedures related to determining a private developer's IVC percentage augments the risk that trust revenue may be lost and the Enabling Act may be violated. Moreover, the Commissioner should also comply with SLO rules and SLO contractual provisions when managing transactions involving state trust land. The rules and requirements help protect and benefit the trust and the related sale of trust land.

The SLO should inform beneficiaries in a timely manner of applications to purchase state trust land. As trustee of New Mexico's state trust lands, the Commissioner has a duty to be transparent with the beneficiaries of state trust lands when reporting on land transactions. Compliance will ensure protection of the trust and create greater transparency in the potential sale of state trust lands. Moreover, the SLO should not mislead trust beneficiaries about the facts regarding any land transaction.

Finally, our examination report details certain risk observations as well as recommendations designed to eliminate those risks. For instance, during our examination we discovered that the millions of acres of land surface rights and mineral rights managed by the Commissioner in his role as a trustee are not included in the SLO financial statements and are thus not included in the SLO's annual financial audit. In the future, the SLO and the OSA should work together with the external auditors who audit SLO's financial statements to develop an approach to audit these trust assets and report them in a meaningful way in the SLO annual audit report. We also make certain risk observations and recommendations related to ethics and conflicts of interest requirements that will help the Commissioner and management prevent, deter and detect potential fraud, waste, and abuse related to the management state trust lands. Additionally, we noted during our examination that state law currently does not provide for campaign contribution disclosure or prohibition requirements that specifically apply to trust land transactions, or prohibit contributions during the Commissioner's application or negotiation process for the exchange, sale or lease of state trust lands. Given that trust land transactions can be in the hundreds of millions of dollars with noticeable monetary benefits to private developers, and the broad discretion with which the Commissioner may manage these transactions, we believe it is prudent and in the best interest of the trust that certain disclosure or prohibition requirements be considered.

New Mexico's state trust lands are valuable resources that generate vital revenue for public education. The findings and risk observations in this examination report, together with the associated recommendations, are intended to provide constructive proposals for improving the current and future management of those resources.

II. BACKGROUND

A. Context and Procedural History of the Special Examination

The OSA engaged in a special examination of state trust land sales, leases and exchanges after a series of events raised significant questions about the Commissioner's award of planning and development leases to private developers and the compensation paid to developers under those leases. The following paragraphs summarize the context and procedural history of our special examination.

The series of events began in late 2006, when Commissioner Patrick Lyons awarded a planning and development lease to a private developer for a tract of state trust land in Las Cruces. On December 22, 25 and 27, 2006, the SLO published a "Notice of Request for Proposals" in the *Las Cruces Sun-News* seeking "proposals for business leases for real estate planning and development . . . for state trust lands within the Las Cruces Extra-Territorial Zone." The notice stated that proposals "should be submitted by 4:00 p.m. on February 1, 2007 to the State Land Office." However, the Commissioner awarded a planning and development lease for a portion of state trust lands in the Las Cruces Extra-Territorial Zone to Phillip Philippou's Solo Investments, LLC (Solo) on December 26, 2006, only four days after the notice was first published in the *Las Cruces Sun-News*. Additionally, a few months prior to the Commissioner's award of the lease, a political action committee (PAC) had received contributions from Mr. Phillippou and then gave campaign contributions on the same days to the Commissioner's re-election campaign.

While the Commissioner stated that the PAC contributions did not influence the award of the lease and that the land deal did not violate state law, these events nevertheless ignited debate over whether the lease award was improper. Furthermore, questions arose over the lease's use of an "improvement value credit" (IVC) which entitled Solo to payment upon termination of the lease for increasing the value of the trust land. On March 9, 2007, these issues became the subject of a request for an Attorney General's Opinion by a New Mexico State Representative. In general, the Representative asked the Attorney General whether the Commissioner's award of the lease to Solo violated the New Mexico Enabling Act, the Constitution of New Mexico and the Governmental Conduct Act.

New Mexico Attorney General Gary King issued Attorney General Opinion No. 08-02 on February 27, 2008 and concluded that the lease "by and between the Commissioner of Public Lands and Solo Investments, LLC contains provisions that are not authorized by New Mexico law." The Opinion addressed the narrow question of whether Solo may receive compensation for the value of "intangible improvements" related to the land developed or obtained by Solo. The lease allowed Solo to complete a development "project" on state trust land, which included preparing a master plan for

development of the land and obtaining approval from the City of Las Cruces for annexation and zoning of the land. Under the lease, the value of these "intangible improvements" was determined by the difference between the appraised values of the land at the beginning and near the expiration of the lease term. Solo would then be entitled to receive an IVC, calculated as a certain percentage of that "change in value" of the land, in addition to Solo's "reasonable project costs," once the Commissioner received payment for the subsequent lease, sale or exchange of the land developed by Solo.

Citing certain provisions of New Mexico law allowing compensation for a lessee's improvements, the Attorney General opined that Solo may only be compensated for "tangible improvements" made to the state trust land and that "the provisions of Solo's lease that allow compensation for intangible improvements are inconsistent with current law." The Attorney General stated that New Mexico law does not allow an owner of improvements to be compensated for the value of improvements as measured by "reasonable project costs" or by a "change in value" of the land. The Attorney General also found that nothing in New Mexico law suggests that "'developmental rights and approvals,' 'changes in value,' or professional or governmental fees are things that belong to a lessee or are otherwise capable of being valued and appraised as improvements." However, while the Attorney General concluded that the Commissioner's lease with Solo contained provisions violating New Mexico law, the Attorney General declined to opine on the lease's enforceability. In sum, the Attorney General stated that "whether the Solo lease is enforceable or not enforceable is a question of law for the courts to determine."

On April 22, 2008, five New Mexico State Representatives sent a letter to the State Auditor requesting that the OSA perform certain procedures related to the SLO's land sales, exchanges and leases. The letter cited the Attorney General's Opinion and requested that the State Auditor examine the SLO's use of IVCs in planning and development leases for state trust land. Following the OSA's review of the letter and preliminary inquiries made by OSA staff to the SLO, the State Auditor determined a special examination was warranted. On May 29, 2008, the State Auditor informed the five legislators and the Commissioner of the general scope of the examination the OSA planned to conduct in accordance with the State Auditor's jurisdiction pursuant to the Audit Act. The scope did not include all the items cited in the letter submitted to the OSA by the five legislators on April 22, 2008. Rather, the general scope of the OSA's special examination work was to test and evaluate the policies and procedures of the SLO regarding sales, exchanges and leases of state trust lands. In general, the scope consisted of audit work related to a population of over 100 state trust land transactions (sales, land exchanges and planning and development leases) for the time period from January 1, 2002 through March 11, 2010. For a detailed description regarding the scope, methodology and assessed risk areas of the special examination, please refer to the Scope and Methodology section of this report.

B. Overview of the State Land Office and State Trust Land Transactions

The sale, exchange or lease of state trust land may occur between the Commissioner and various other parties, including private individuals, businesses, and governmental entities. The following sections are intended to provide the readers of this report with pertinent background information about laws, rules, policies and procedures applicable to the types of state trust land transactions that we examined within the scope of our special examination.

1. The Enabling Act and the Commissioner of Public Lands

The Enabling Act, passed by the United States Congress prior to New Mexico gaining statehood, granted certain lands to New Mexico to be held in trust by the state "for the support of common schools."[1] The Act places certain restrictions on the disposition of trust lands. Among other restrictions, the Act requires that trust lands "be sold or leased . . . to the highest and best bidder at a public auction," except that trust lands may be leased for a term of five years or less without public auction.[2] The Act also requires that trust lands be "appraised" and disposed of "at their true value," and mandates that legal title to trust lands cannot be conveyed until consideration is paid.[3] The Enabling Act also provides that the proceeds from the disposition of the trust lands or its "natural products" can only be used in accordance with the provisions of the Act: "Every sale, lease, conveyance or contract of or concerning any of the lands hereby granted or confirmed . . . not made in substantial conformity with the provisions of this act shall be null and void."[4] New Mexico consented to the provisions of the Enabling Act pursuant to Article XXI, Section 9, of the Constitution of New Mexico.

Pursuant to the Enabling Act and the Constitution, the Commissioner of Public Lands is the trustee of New Mexico's trust lands. The Commissioner is a statewide office of the executive department and is elected by the citizens of New Mexico to four-year terms.[5] As such, the Commissioner is the executive officer of the SLO. In accordance with Article XIII, Section 2 of the Constitution, the Commissioner "shall select, locate, classify and have the direction, control, care and disposition of all public lands, under the provisions of the acts of congress relating thereto and such regulations as may be provided by law."

In 1989, New Mexico enacted a law creating the State Land Trusts Advisory Board, which consists of seven members appointed by the Commissioner with the advice and consent of the New Mexico State Senate. The Board's membership is required to represent a "geographical balance from across the state" and include members who represent the beneficiaries of state land trusts, the extractive industries, the agricultural industries, conservation interests, and the public at large.[6] The terms of Board members

[1] Act of June 20, 1910, 36 Stat. 557, Ch. 310 (the "Enabling Act"), Section 6.
[2] Enabling Act, Section 10.
[3] *Id.*
[4] *Id.*
[5] Constitution of New Mexico, Article V, Section 1.
[6] Section 19-1-1.1(B) NMSA 1978.

are limited to six years. The Board's duties are "to provide a continuity for resource management and to help the commissioner of public lands with understanding and maintaining the highest standards for maximizing the income from the trust assets, and to protect and maintain the assets and resources of the trust" as required by law.[7] The Board's actions are not binding on the Commissioner, "who alone has the constitutional and fiduciary responsibility as trustee for the trusts."[8]

Revenues from trust lands benefit New Mexico's public schools and other beneficiary institutions. The Commissioner generates revenues for the beneficiaries through the sale, lease, exchange and management of state trust assets. The Commissioner may lease trust lands for various surface and subsurface activities, including grazing, agriculture, and oil and gas drilling. In addition, the Commissioner earns revenues from the sale of state trust lands and through royalties from nonrenewable resource production from state trust lands. Accordingly, the Commissioner's specified statutory duties include the duty to "receive and pass upon all applications for leasing or purchasing state lands and timber," and the duty to "execute and authenticate for the state all deeds, leases, contracts or other instruments affecting such lands."[9] The Commissioner has authority over approximately 8.5 million acres of surface rights and approximately 13 million acres of mineral rights in New Mexico.[10] In 2009, the state trust lands realized total revenues of $536.5 million and the total 2009 distributions to beneficiaries were $566.7 million.[11]

The scope of our special examination examined three types of land transactions administered by the Commissioner that generate revenues for trust beneficiaries: land sales, land exchanges, and planning and development leases. The following sections describe the statutes, administrative rules, and internal policies and procedures of the SLO as they apply to the aforementioned transactions.

2. Land Sales

The Enabling Act and the Constitution of New Mexico grant the Commissioner the authority to sell state trust lands. Article XIII, Section 2 of the Constitution provides that the Commissioner shall "have the direction, control, care and disposition of all public lands, under the provisions of the acts of congress relating thereto and such regulations as may be provided by law." New Mexico statutes and administrative rules promulgated by the Commissioner implement Article XIII, Section 2 and specify the requirements by which the Commissioner executes sales of trust lands.

Generally, New Mexico statutes applicable to the sale of state trust lands are found in Chapter 19, Sections 1 and 7 NMSA 1978. Section 19-1-1 NMSA 1978 provides that the Commissioner "shall have jurisdiction over all lands owned in this

[7] Section 19-1-1.4(A) NMSA 1978.
[8] Section 19-1-1.4(B) NMSA 1978.
[9] Section 19-1-2 NMSA 1978.
[10] Audit of Financial Statements for Fiscal Year Ended June 30, 2009, State of New Mexico Commissioner of Public Lands, p.20.
[11] *Id*, Management's Discussion and Analysis, p.4.

chapter by the state, except as may be otherwise specifically provided by law, and shall have the management, care, custody, control and disposition thereof *in accordance with the provisions of this chapter* and the law or laws under which such lands have been or may be acquired."[12] The Commissioner is statutorily required to promulgate "rules and regulations for the control, management, disposition, lease and sale of state lands." Accordingly, the Commissioner issued Rule 19.2.14 NMAC (Rule 14) entitled "Pertaining to Land Sales," in order "to provide for the orderly and lawful sale of state trust lands, assets and resources."[13]

The Enabling Act requires that trust lands be "appraised" and sold "at their true value." The Act also requires that trust lands cannot "be sold or leased . . . except to the highest and best bidder at a public auction." Consistent with this requirement, Section 19-7-9 NMSA 1978 and Rule 19.2.14.8 NMAC provide that state trust lands may be sold at public auction at the Commissioner's "discretion." Furthermore, Rule 19.2.14.9(D) NMAC states that nothing contained in the administrative rules "shall be construed as preventing the commissioner on his own initiative at any time from offering for sale all or part of any lands of the state when the commissioner determines that such sale is in the best interest of the trust."

Although state trust lands must be sold to the highest and best bidder at public auction, an application to purchase state trust lands may be filed with the Commissioner by any person. The Commissioner is required to advise the applicable beneficiary institution "of the receipt of any application to purchase."[14] Pursuant to Rule 19.2.14.9 NMAC, applications to purchase state trust lands shall be made upon forms prescribed by the Commissioner and be accompanied by a $30 fee, a deposit of $500, and an appraisal of the land by a "disinterested and creditable person familiar with the land."[15] The Rule further requires that the "appraisal shall be based upon personal knowledge and not information and belief," but that the "appraisal shall not be binding upon the commissioner."[16] The successful bidder is required to pay the total cost of advertising, appraising, and sale and is billed for any cost in excess of the deposit.

Based on our interviews with SLO management, the SLO's Commercial Resources Division (CRD) processes the applications for land sales. The application is assigned to an analyst within the Division. The CRD enters the name of the applicant and the proposed purchase of the state trust land in the tract books located in the SLO's Records Division. The CRD will assign a land sale number (LS #) which is entered in the ONGARD system. The ONGARD system, which stands for Oil and Natural Gas Administration and Revenue Database, is a computer system that tracks oil and gas production, taxes and royalties in a relational database. The ONGARD system also includes an inventory of state trust land, lease descriptions, well locations, exploration information, royalty, and other trust revenue figures, as well as distribution and collection data. The CRD then requests an analysis of the application and field reviews from the

[12] Emphasis added.
[13] Rule 19.2.14.6 NMAC.
[14] Rule 19.2.14.8(A) NMAC.
[15] Rule 19.2.14.9(C) NMAC.
[16] *Id*.

SLO's Field Operations Division and other personnel within the SLO that are most knowledgeable about the state trust land. The field reviews requested by CRD include criteria regarding the current type and condition of the land, current SLO activity on the land (oil, gas and mineral leases, agricultural leases, business leases, rights-of-way, etc.), the highest and best use of the land and any other pertinent information.

After reviewing the application, supporting documentation, and the analysis and recommendations provided by SLO staff, the Commissioner decides whether or not to proceed with the sale. Upon a "preliminary determination that the sale might be advantageous to the trust," the Commissioner is required to cause an appraisal of the land and the authorized improvements to be made.[17] As a part of SLO's internal control process, the SLO's in-house appraiser reviews appraisals of the state trust land submitted during the application process for reasonableness, accuracy and compliance with professional appraisal standards (USPAP), and submits his or her findings and recommendations in a review report to the Commissioner. If the applicant agrees with the appraisal of the land and the improvements, the applicant shall file with the Commissioner a sum equal to the appraised value of the improvements or post a bond to assure payment. Upon payment or posting of the bond, the Commissioner may proceed to advertise the sale for public auction.[18]

Rule 14 requires that the notice of sale be published once each week for ten consecutive weeks in a newspaper of general circulation published locally at Santa Fe, New Mexico, and a newspaper of like circulation which is locally published nearest the lands offered for sale. In accordance with the Enabling Act, the land must be sold to the "highest and best bidder at public auction."[19] To qualify as a bidder, the prospective bidder must deposit with the Commissioner $530.00 to cover the cost of the sale and ten percent of the appraised value of the lands. The prospective bidder must also deposit with the Commissioner the appraised value of any improvements made to the land, a waiver of payment signed by the owner of the improvements, or a bond sufficient to cover the appraised value, unless the prospective bidder is the owner of the improvements.[20] The Commissioner may conduct an oral auction or accept sealed bids, which are required to be opened at the time of the auction.

The Commissioner may accept full payment from the successful bidder or payment by installments under a purchase contract, provided the Commissioner provided notice that he will accept payment by purchase contract. Section 19-7-9 NMSA 1978 requires that payment under a purchase contract be at least "one-tenth of the purchase price in cash and payment of the balance in amortized installments for any period up to thirty years with interest on the principal balance at a rate to be set by the commissioner in the notice of auction." At the closing of the land sale, SLO personnel collects the sale proceeds from the purchaser and deposits the balance into the land grant permanent fund at the State Investment Council for periodic distributions to the beneficiaries of the state

[17] Rule 19.2.14.10(A) NMAC.
[18] Rule 19.2.14.10(B) NMAC.
[19] Rule 19.2.14.13 NMAC.
[20] Rule 19.2.14.12(C) NMAC.

trust land pursuant to Section 19-1-20(B) NMSA 1978, Article XII, Section 7 of the Constitution of New Mexico and the Enabling Act.

3. Land Exchanges

The Commissioner engages in the practice of exchanging trust lands for non-trust lands "when such exchanges will result in a material benefit to the trust not otherwise available, and when the exchange of such trust lands would benefit the trust more than their retention."[21] Rules pertaining to land exchanges are found in Rule 19.2.21 NMAC (Rule 21). As authority for conducting exchanges, the Commissioner's rules cite Article XIII, Section 2 of the Constitution of New Mexico, which provides that the Commissioner shall "have the direction, control, care and disposition of all public lands, under the provisions of the acts of congress relating thereto and such regulations as may be provided by law." The rules also cite Section 19-1-1 NMSA 1978, which provides that the Commissioner "shall have jurisdiction over all lands owned in this chapter by the state, except as may be otherwise specifically provided by law, and shall have the management, care, custody, control and disposition thereof in accordance with the provisions of this chapter and the law or laws under which such lands have been or may be acquired."

In accordance with Rule 21, the Commissioner may exchange trust lands for non-trust lands owned in fee simple absolute by an "exchange party," which can be a governmental entity or a private entity or entities. The Commissioner enters into exchanges at his discretion, specifically when he "determines that the exchange will result in a material benefit to the trust and the purpose of the exchange would serve the best interests of the trust."[22] A single exchange transaction may involve multiple exchange parties or multiple parcels of trust land.[23] Non-trust lands the Commissioner receives from an exchange, and any proceeds, are "applied to and become a part of the trust for which the trust lands exchanged by the commissioner were originally granted."[24]

In all exchanges, the trust "must receive at least true value for the trust lands that are conveyed to an exchange party."[25] The Commissioner can only proceed with an exchange after determining that "the non-trust lands to be received by the state are of equal or greater value to the trust."[26] In order to make this determination, the Commissioner's rules require the Commissioner to "appraise the trust lands and the non-trust lands proposed to be exchanged at their true value."[27] "True value" is defined as "fair market value as determined by any objective, reliable and commercially acceptable method including but not necessarily limited to appraisal by an appraiser."[28] However, the Commissioner has the sole discretion to select who may conduct the appraisal or what method may be used to determine true value. According to Rule 21, the Commissioner

[21] Rule 19.2.21.6 NMAC.
[22] Rule 19.2.21.8(A) NMAC.
[23] Rule 19.2.21.8(E) NMAC.
[24] Rule 19.2.21.8(D) NMAC.
[25] Rule 19.2.21.8(C) NMAC.
[26] *Id.*
[27] *Id.*
[28] Rule 19.2.21.7(R) NMAC.

may select (1) a qualified state land office employee; (2) a qualified appraiser selected or approved in advance by the Commissioner; (3) a qualified appraiser not selected or approved in advance by the Commissioner but whose appraisal report is reviewed by either a qualified state land office employee or a different qualified appraiser, and such review arrives at an independent assessment of value; or (4) another method of determining true value if the Commissioner determines that such method is in the best interests of the trust and conform to law.[29]

Either the Commissioner or a governmental entity or private entity may initiate a proposed exchange. Rule 21 grants the Commissioner the authority to approach potential exchange applicants at his discretion. Specifically, Rule 19.2.21.9(A) NMAC provides that the Commissioner "may engage in preliminary informal discussions or other preliminary communications with potential exchange applicants prior to any exchange application or exchange proposal being submitted and prior to any publication soliciting exchange proposals." If the exchange is initiated by an exchange applicant, the applicant must file an initial application which includes a legal description of the non-trust lands proposed to be exchanged; the estimated market value of the non-trust lands; the current uses of the non-trust lands; ownership of the non-trust lands; a description of any known environmental or cultural property issues related to the non-trust lands; a legal description of the trust lands that the applicant seeks to acquire; an estimate of the value of such trust lands; and the applicant's reason for wishing to pursue the exchange.[30] However, the Commissioner may waive any or all of these requirements for the exchange applicant if "he determines in his discretion that so doing is in the best interest of the trust."[31]

Based on our interviews with SLO management, the CRD processes the applications for land exchanges. The application is assigned to an analyst within the Division. The CRD enters the name of the applicant and the proposed exchange of the state trust land in the tract books located in the SLO's Records Division. The CRD assigns the exchange a land exchange number (LE #) which is entered in the ONGARD system. The CRD then requests an analysis of the application and field reports from the Field Operations Division and other personnel within SLO that are most knowledgeable about the state trust land, including the current type and condition of the land, current SLO activity on the land (oil, gas and mineral leases, agricultural leases, business leases, rights-of-way, etc.), and the highest and best use of the land. Also, as with land sales, the SLO's in-house appraiser reviews appraisals of the state trust land submitted during the application process for reasonableness, accuracy and compliance with professional appraisal standards (USPAP), and submits his or her findings and recommendations in a review report to the Commissioner.

After review of the application, the Commissioner may determine that that the suggested exchange does not offer sufficient potential benefit to the trust and terminate the exchange process.[32] The Commissioner may also determine that further investigation of the suggested exchange is warranted. Upon this determination, and if the exchange

[29] Rule 19.2.21.8(C) NMAC.
[30] Rule 19.2.21.9(B)(2) NMAC.
[31] *Id.*
[32] *Id.*

applicant wishes to proceed, the applicant must submit an exchange proposal to the Commissioner. Rule 21 requires that the exchange proposal include multiple items, including a survey plat of the non-trust lands; an appraisal of the non-trust lands; a complete listing of the improvements on the non-trust lands; a description of any water rights on the non-trust lands; the identification of any leases, easements, or other interests affecting the non-trust lands; a complete listing of any known cultural properties located on the non-trust lands; a complete description of any environmental hazards, threatened or endangered species or mineral rights on the non-trust lands; a description of the trust lands that the applicant seeks to acquire; a survey plat and appraisal of the trust lands the applicant proposes to acquire; and any other information or documentation regarding those trust lands which the Commissioner determines is necessary to evaluate the proposal.[33] Similar to the exchange application submission, the Commissioner may "waive or modify any of the foregoing exchange proposal requirements, unless otherwise governed by law, if he determines that such waiver or modification is in the best interest of the trust."[34]

Following his review of the applicant's exchange proposal and any other supplemental documentation he required, the Commissioner determines "whether or not the proposed exchange appears to offer sufficient benefit the trust to warrant proceeding further with the exchange process."[35] The exchange process terminates if the Commissioner determines the proposed exchange does not offer sufficient benefit. If the Commissioner determines the proposed exchange does offer sufficient benefit, Rule 21 requires that the Commissioner publish an advertisement soliciting additional exchange proposals.[36] The Commissioner must publish the advertisement once each week for not less than ten successive weeks in a newspaper of general circulation published regularly at Santa Fe and also in the newspaper of general circulation published regularly nearest the location of the trust lands offered for exchange. The Commissioner may also post the advertisement on the SLO website.[37] All exchange proposals submitted in response to the advertisement must conform to the requirements for exchange proposals under Rule 21.

In instances where there is no initial exchange applicant and the Commissioner arrives at his own "preliminary determination" that an exchange would best serve the trust, the Commissioner initiates the exchange process by publishing an advertisement soliciting exchange proposals.[38] The advertisement and the Commissioner's subsequent review and selection of exchange proposals must also follow the process described below.

The Commissioner must make a determination on the exchange proposals "within a reasonable time" after the deadline required for submission. [39] After review of all

[33] Rule 19.2.21.9(B)(4) NMAC.
[34] Rule 19.2.21.9(B)(4)(q) NMAC.
[35] Rule 19.2.21.9(B)(6) NMAC
[36] *Id*.
[37] Rule 19.2.21.9(D) NMAC.
[38] Rule 19.2.21.9(C) NMAC.
[39] Rule 19.2.21.10(A) NMAC.

exchange proposals submitted, the Commissioner may select the proposal or proposals "he determines are the highest and best" in accordance with Rule 21.[40] More specifically, the Commissioner's determination must comply with the requirements that (1) the exchange will result in a material benefit to the trust; (2) the purpose of the exchange would serve the best interests of the trust; and (3) the trust will receive at least the true value for the trust lands that are conveyed to the exchange party. The Commissioner may request additional information and "conduct a supplemental competitive process" before making a final decision if he selects more than one exchange proposal as the "highest and best."[41]

Once the Commissioner makes a final decision and selects an exchange proposal, the Commissioner and the exchange applicant enter into a written exchange agreement before the exchange is consummated. The exchange is consummated "by a simultaneous exchange of conveyance documents between the commissioner and the exchange party."[42] The Commissioner then records and files the conveyance documents with SLO's Records Division and the exchange party records the conveyance documents with the appropriate county clerks.

The Commissioner is only required to provide notice of the exchange to certain trust beneficiaries upon consummation of the exchange. Rule 21 requires the Commissioner to submit "a written report to all beneficiary institutions involved setting forth a description of the trust lands and the non-trust lands involved, their appraised values, his reason for believing that the exchange will benefit the trust, and any other information he deems desirable."[43] At all other points in the exchange process it is in the Commissioner's discretion as to whether beneficiary institutions receive notification of the proposed exchange. Rule 21 provides that Commissioner may notify beneficiary institutions upon publication of a request for exchange proposals. In that case, the Commissioner, in his discretion, may submit to the beneficiary institutions "for whose benefit the trust lands proposed to be exchanged are held in trust a copy of the request for exchange proposals and any statement of the commissioner's reasons for believing that such an exchange will be beneficial to the trust and to the beneficiary institutions."[44] Also, upon entering into an exchange agreement, the Commissioner may, in his discretion, "submit to the beneficiary institutions a copy of the exchange agreement and any explanatory materials he finds appropriate."[45]

4. Planning and Development Leases

The Commissioner generates revenues for the trust by leasing trust lands for various purposes, including grazing, agriculture, mining and commercial use. In fiscal year 2009, the Commissioner's land leasing program managed 782 active commercial leases covering 403,622 acres of trust land, resulting in $6.5 million in revenue for the

[40] *Id.*
[41] *Id.*
[42] Rule 19.2.21.14 NMAC.
[43] Rule 19.2.21.13(B) NMAC.
[44] Rule 19.2.21.13(A) NMAC.
[45] *Id.*

trust.[46] Planning and development leases are types of business leases managed by the Commissioner. Current administrative rules promulgated by the Commissioner define a planning and development lease as "a written lease of trust land issued . . . designed to improve the value of trust land for future sale, lease, or exchange."[47] The Commissioner's stated goal when entering a planning and development lease is to create a greater increase in the value of the state trust land under the lease, and return for the trust, than would have occurred if that land had not been leased.

Prior to 2009, the Commissioner was not required to seek competitive bids before entering into planning and development leases for terms of five years or less. The Enabling Act provides that the Commissioner may not lease state trust lands "except to the highest and best bidder at a public auction," but that trust lands may be leased for a term of five years or less without public auction.[48] However, in 2009 the New Mexico Legislature limited the Commissioner's authority under the Enabling Act to issue certain planning and development leases without a public auction. Section 19-7-9 NMSA 1978 provides that the Commissioner may lease state trust lands for commercial development of public use purposes for any period of time, provided that the following requirements are met:

- The leases comply with the Constitution of New Mexico and the Enabling Act, including requirements related to appraisal of trust lands at true value and public auction requirements;
- The term and nature of the trust lands leased is set forth in the public notice of auction that pertains to the particular lease;
- If the lease is a commercial lease for planning and development purposes, then the Commissioner can only issue the lease after notice and competitive bid.

On October 30, 2009, the Commissioner issued Rule 19.2.22 NMAC (Rule 22), entitled "Planning and Development Leases," for the following objective: "to generate value to the trust by planning and development of trust land for future sale, lease, or exchange thru the process of obtaining government approvals and other infrastructure pertinent to the planning and development of the land; to assure protection and maintenance of trust assets and lands; to provide planning and development lease terms and conditions; and to provide an efficient process for such leasing."[49] Prior to October 30, 2009, the Commissioner issued planning and development leases under Rule 19.2.9 NMAC (Rule 9), entitled "Business Leasing," which was promulgated on May 5, 2001. The primary difference between Rule 9 and Rule 22 is that Rule 22 requires a competitive bidding process for planning and development leases with terms of five years or less. Aside from this distinction, Rule 22 essentially codifies the process, including the Commissioner's use of improvement value credits (IVC), that the SLO employed to issue planning and development leases under Rule 9.[50] The vast majority of planning and

[46] 2009 Annual Report, New Mexico Commissioner of Public Lands, p.13.
[47] Rule 19.2.22.7(M) NMAC.
[48] Enabling Act, Section 10.
[49] Rule 19.2.22.6 NMAC.
[50] The Commissioner still uses Rule 9 to issue other types of business leases.

development leases reviewed during the OSA's special examination were issued under Rule 9.

The Commissioner may offer to lease trust land under a planning and development lease "on his own initiative" or upon the receipt of an application.[51] The application process for a planning and development lease between Rule 9 and Rule 22 differs slightly. Under Rule 9, any person could propose that the Commissioner enter into a planning and development lease by submitting an application to the Commissioner on forms prescribed by the Commissioner.[52] Rule 9 required that the application for a planning and development lease "include a written appraisement of the trust land proposed for lease made under oath by a disinterested and credible person. All statements contained in such appraisements, except as to the true value of the land appraised, must be based upon personal knowledge and not upon information and belief."[53] The Commissioner could enter into negotiations with an applicant for a lease of five years or less upon receipt of an application, and Rule 9 only required a competitive bid process for leases with terms exceeding five years.

Rule 22, however, provides that a person may "nominate any trust land for a planning and development lease by submitting an application" to the Commissioner. The Commissioner then evaluates the nomination according to a set of criteria, including (1) an estimation of present and future value created for the trust; (2) the anticipated impact on trust land adjacent or near the nominated trust land; (3) the feasibility of the proposed project; and (4) any other factors the commissioner deems relevant.[54] If the Commissioner finds the trust land suitable for a planning and development lease, the applicant must provide an appraisal of the trust land "by a licensed appraiser approved by the commissioner."[55] The Commissioner then may offer the planning and development lease through a public auction process.

Under planning and development leases, lessees are compensated for the value of their improvements through the Commissioner's grant of an IVC to the lessee. New Mexico law requires that lessees are compensated for improvements they make to state trust lands. Section 19-7-14 NMSA 1978 provides that "[w]henever any state lands are sold or leased to a person other than the holder of an existing surface lease and upon which lands there are improvements belonging to such lessee . . . the purchaser or subsequent lessee . . . shall pay to the commissioner of public lands for the benefit of the owner of the improvements the value thereof as determined by an appraisal made by the commissioner of public lands." Therefore, Rule 9 defines an IVC as a credit granted to the lessee by the Commissioner for the lessee's permanent improvements to the land, including intangible improvements, which entitles the lessee to payment upon the subsequent lease or sale of the trust land.[56] Rule 22 uses the term "planning development credit," but the terms "improvement value credit" and "planning development credit" are

[51] Rule 19.2.9.8(C) and Rule 19.2.22.8(B) NMAC.
[52] Rule 19.2.9.9 NMAC.
[53] Rule 19.2.9.9(B) NMAC.
[54] Rule 19.2.22.9(D).
[55] Rule 19.2.22.9(F) NMAC.
[56] Rule 19.2.9.7(I) NMAC.

synonymous in the context of planning and development leases. "Planning development credit" is defined as "a credit granted by the commissioner to a lessee for increased value to trust land as a result of the lessee's placement of infrastructure or procurement of government approvals. This credit will be granted upon subsequent lease, sale, or exchange of the benefitted trust land."[57] As previously discussed, Attorney General's Opinion 08-02 concluded that New Mexico law only allows compensation to lessees for "tangible improvements" made to the land and that compensation for intangible improvements is inconsistent with current law. Rule 22 continues to allow compensation for intangible improvements under planning and development leases.

In general, lessees who enter into planning and development leases with the Commissioner are entitled to IVCs in return for preparing master plans for development of the trust land and for obtaining from government agencies certain legal rights related to the land, including zoning, platting and development agreements. For planning and development leases issued under both Rule 9 and Rule 22, the IVC is determined by a series of appraisals of the trust land performed near the beginning and end of the lease term. First, near the beginning of the lease term, a certified real estate appraiser conducts a "first round appraisal" to determine the "base appraisal value" (BAV) of the land. The appraisal is conducted at the lessee's expense and is subject to the review and approval of the Commissioner. Following the lessee's improvements to the land and near the end of the lease term, a "second round appraisal" is conducted by a certified real estate appraiser to determine the "final appraised value" or "sale appraisal value" (SAV) of the land. That appraisal is also conducted at the lessee's expense and is subject to the review and approval of the Commissioner. The difference between the BAV and SAV is then calculated to reach the "gross credit" or "change in value" of the trust land. The lessee is entitled to a percentage of the change in value upon the subsequent sale, exchange or lease of the trust land. The IVC "split," or the IVC percentage to which the lessee is entitled, and the IVC percentage which is retained by the trust, is determined at the discretion of the Commissioner and is negotiated prior to execution of the lease. A planning and development lease may provide that an IVC may depreciate over time if there is no successor in interest, other than the Commissioner, after termination of the lease.

For planning and development leases executed under Rule 9, the lessees, or developers, were entitled to their "reasonable project costs" in addition to payment of the IVC. Generally, those costs were subject to the approval of the Commissioner and included expenses incurred by the developer for planning and platting the land leases. Under Rule 22, however, the developer's reasonable project costs are deducted from the SAV prior to calculation of the IVC. That rule defines "reasonable project costs" as "those sums paid or credited in acquiring the lease at auction less any bonus bid amounts, plus any costs approved by the commissioner incurred in securing government approvals or infrastructure through professional services as well as costs associated with the development of physical infrastructure."[58]

[57] Rule 19.2.22.7(N) NMAC.
[58] Rule 19.2.22.7(O) NMAC.

Based on our interviews with SLO management, the CRD processes the applications for planning and development leases. The application is assigned to an analyst within the Division. The CRD enters the name of the applicant and the proposed lease of the state trust land in the tract books located in the SLO's Records Division. The CRD then assigns a business lease number (BL #) which is entered in the ONGARD system. The CRD then requests an analysis of the application and field reports from the Field Operations Division and other personnel within SLO that are most knowledgeable about the state trust land including the current type and condition of the land, current SLO activity on the land (oil, gas and mineral leases, agricultural leases, business leases, rights-of-way, etc.), and the highest and best use of the land. Also, as with land sales and land exchanges, the SLO's in-house appraiser reviews appraisals of the state trust land for reasonableness, accuracy and compliance with professional appraisal standards (USPAP), and submits his or her findings and recommendations in a review report to the Commissioner.

Based on negotiations with the applicant, the Commissioner determines the terms of the lease. These terms include the base annual rent, the IVC percentages allocated to the applicant and the Commissioner upon the subsequent sale of the trust land, and depreciation provisions for the IVC. Under Rule 9, the terms also included reimbursement to the applicant for reasonable project costs upon the subsequent sale of the trust land. The lease payments are deposited into the proper fund and distributed to the applicable beneficiaries of the state trust land. At anytime during the lease or at the end of the lease term, the developer can submit an application to purchase the improved trust land in accordance with the land sale procedures noted above.

Before the sale, exchange or lease of the trust land closes, SLO personnel reviews the documentation submitted by the developer for its project costs to determine if the costs are allowable and reasonable. At the closing of the sale, exchange or lease, SLO personnel will collect the proceeds and pay the amount of the IVC to the lessee, reimburse the lessee for its reasonable project costs,[59] and deposit the remaining balance into the land grant permanent fund at the State Investment Council for the future distribution of investment interest to the beneficiaries of the state trust land.

III. SCOPE AND METHODOLOGY

The general scope of the OSA's special examination was to test and evaluate the policies and procedures of the SLO regarding sales, exchanges and leases of state trust land. The initial phase of the special examination involved information gathering. A critical part of the information gathering included reviewing the laws governing the trust land granted to the State of New Mexico by the Enabling Act, the laws governing the Commissioner and the SLO, and the SLO's administrative rules for land sales, land exchanges, business leases, planning and development leases and land appraisals. The information gathering process also included, but was not limited to, interviewing key personnel at the SLO who are involved with the trust land sale, exchange and lease

[59] As previously mentioned, under Rule 9 lessees were entitled to their "reasonable project costs" in addition to payment of the IVC. Under Rule 22, however, the developer's reasonable project costs are deducted from the SAV prior to calculation of the IVC.

processes. We also reviewed information brought to our attention that related to these processes.

Through the information gathering process, we obtained an understanding of the SLO's policies and procedures for processing trust land sales, land exchanges, and planning and development leases. Based on our understanding of the SLO's policies and procedures and assessed risk areas, our office developed special examination procedures to be performed. The assessed risk areas included, but were not limited to, the following: 1) whether transactions may have occurred that did not benefit the trust; 2) whether the SLO has adequate policies and procedures in place to safeguard trust lands and whether the SLO followed those policies and procedures; 3) the Commissioner's negotiation process related to land exchanges; 4) the SLO's current process to ensure land valuations are appropriately supported; 5) the Commissioner's justification for land exchanges; 6) potential conflicts of interest related to land transactions; and 6) whether the SLO has adequate internal controls and whether there was an override of those controls.

Upon obtaining requested information from the SLO, such as a listing of land sales, land exchanges and planning and development leases, we selected samples of transactions to test for compliance with statutes, administrative rules and other applicable criteria. Our test work involved land sales, land exchanges and planning and development leases executed during the time period of January 1, 2002 through March 11, 2010.

For the final phase of the special examination, we incorporated the results of the examination procedures performed into this report. Any instances of noncompliance, lack of internal controls, improper internal controls, contractual violations or other deficiencies are included in the following Findings and Risk Observations sections of this examination report.

IV. FINDINGS AND RISK OBSERVATIONS

Finding 01 – Land Exchange Not in the Benefit of the Trust

Final Exchange Information

The Commissioner executed a land exchange agreement with Bowlin Travel Center on August 29, 2008. The Commissioner conveyed 30.07 acres of state trust land to Bowlin in exchange for 1 acre of Bowlin land. The state trust land of 30.07 acres was valued at $225,600 and the 1 acre of Bowlin land was valued at $240,000. Therefore, the exchange resulted in a net gain of $14,400 in value of land exchanged. However, the SLO relinquished six leases on the trust land because of the exchange. We identified the following deficiencies related to the exchange.

Condition

Prior Business Lease Income

The exchange does not appear to have been in the benefit of the trust, but in the best interest of the private party because the lease revenue in one year was greater than the entire value of the exchange. Prior to the exchange, the SLO executed seven leases on the 30.07 acres of state trust land. One lease, BL-0514, brought in $11,464 in annual lease revenue in 2008. Six other billboard leases, BB-42 through BB-47, brought in $3,180 in annual lease revenue. In total, the leases relinquished because of the exchange amounted to $14,644 in lease revenue in 2008. The lease revenue in one year exceeds the entire exchange gain value of $14,400. Also, the exchange gain value does not take into account the future lease revenue relinquished as a result of the exchange.

Appraisal

Initially, an appraisal performed by an external certified appraiser for the exchange resulted in an appraised value of 15 acres of state trust land at $4,500 per acre. Yet, the final transaction conveyed to the private party 30.07 acres valued at $7,500 an acre. There was no documentation in the exchange file folder that explains or supports how the 15 acres of trust land initially appraised for the exchange increased to 30.07 acres in the final agreement. However, documentation in the file shows that the Assistant Commissioner of Commercial Resources, who is not a certified appraiser, arbitrarily increased the appraised value of the land. In a memorandum to the Deputy Commissioner, the employee stated, "[b]ased on my knowledge of the market, the information gained in my researching this project and overall real estate activity in the area, I have determined a fair market value of the property be advertised at $7,500 per acre. This is in excess of the conclusion reached in the appraisal on file, but reflects my perspective, being responsible for all commercial leasing and sale activity for the New Mexico State Land Office." The documentation does not evidence that the SLO used an objective, reliable and commercially acceptable method to determine the true value of the land to be exchanged.

Lack of Financial Analysis

The SLO's letter to the trust beneficiaries, written by same Assistant Commissioner who arbitrarily increased the appraised value of the land, indicates, "[a]n analysis of the proposed land exchange has been completed. Based upon the analysis, it has been determined that the exchange/sale is in the best interest of the trust and the beneficiary."

However, we did not locate a financial analysis related to the exchange in the exchange file, nor was a financial analysis related to the exchange otherwise provided to us.

Beneficiary Notification

The Assistant Commissioner's letter to the trust beneficiaries also contained misleading language. Under the "Appraised Value" section of the letter, the language read the following: "A recent formal appraisal was conducted by (external appraiser), on September 15, 2007, The [sic] minimum bid was established at $225,600 resulting in a $7500.00 per acre." This language implies that the external certified appraiser appraised the land at $7,500 per acre; however, the external certified appraiser appraised only 15 acres of land at $4,500 per acre. It was the Assistant Commissioner of Commercial Resources, who is not a certified appraiser, who set the value at $7,500 per acre, based only on that employee's "perspective."

Criteria

Rule 19.2.21.6 NMAC defines the objective of land exchanges as the following: "The objective of this part is to provide for the orderly and lawful exchange of trust lands when such exchanges will result in a material benefit to the trust not otherwise available, *and when the exchange of such trust land would benefit the trust more than their retention*." (Emphasis added). Furthermore, Rule 19.2.21.8 NMAC provides that "the commissioner may enter into an exchange when the commissioner determines that the exchange will result in a material benefit to the trust and the purpose of the exchange would serve the best interests of the trust." A critical tool in determining whether or not an exchange is in the best interest of the trust is a financial analysis.

In addition, all values of land to be exchanged, whether trust land or private land, should be determined in accordance with SLO rules. Rule 19.2.21.7(R) NMAC defines "true value" as "fair market value as determined by any objective, reliable and commercially acceptable method including but not necessarily limited to appraisal by an appraiser." Rule 19.2.21.8(C) NMAC provides that "[i]n any exchange, the trust must receive at least true value for the trust lands that are conveyed to an exchange party."

Finally, Rule 19.2.21.13(B) NMAC requires the Commissioner to submit a written report to all beneficiary institutions involved setting forth a description of the trust land and the non-trust lands involved, their appraised values, his reason for believing the exchange will benefit the trust and any other information he deems desirable.

Effect

The beneficiaries of state trust land may have suffered a financial loss due to land lease revenue relinquished by the Commissioner and a net loss of 29 acres of trust land. The value of the land exchanged is also questionable when arbitrarily increased without support. Moreover, the trust beneficiaries were misled by the Assistant Commissioner's language in his beneficiary letter. Transparency is compromised when support for transactions are not provided.

Cause

It does not appear that the SLO performed any documented financial analysis for this exchange that would have identified that this transaction was in the best interest of the trust. Additionally, the Assistant Commissioner of Commercial Resource, who is not a certified appraiser, arbitrarily increased the value of the state trust land. There also was no objective, reliable and commercially acceptable method to determine the true value of the land to be exchanged. Overall, there appears to be an override of internal controls by the Commissioner.

Recommendation

The SLO should perform a financial analysis on all proposed exchanges to ensure that all land exchanges executed by the Commissioner are in the benefit of the trust. At a minimum, prior to relinquishing leases on land involved in a potential exchange, the SLO should analyze and compare the total lease revenue and future lease revenue to the overall gain from the exchange. The Commissioner should ensure SLO employees conduct such an analysis for each exchange and retain the analysis as supporting documentation for the exchange. Also, the financial analysis would promote transparency and public access to information regarding the management of state trust lands.

The trust is compromised when the Commissioner fails to use an objective, reliable and commercially acceptable method to determine the true value of trust lands involved in an exchange. SLO employees should not alter the value of land without cause, proper support, or the use of an objective, reliable and commercially acceptable method to determine the true value. Moreover, the Commissioner should not approve SLO employees' action that fail to meet this requirement for determining "true value."

The Commissioner and SLO employees should not mislead trust beneficiaries about the facts regarding any land transaction. As trustee of New Mexico's state trust lands, the Commissioner has a duty to be truthful and transparent with the beneficiaries of state trust lands when reporting on land transactions.

Finding 02 – Land Sale Not in the Benefit of the Trust

Final Sale Information

The Commissioner sold state trust land to Lea County in February of 2008. The sale resulted in a conveyance of 26.33 acres of state trust land to Lea County for a sales price of $71,500 ($2,716 per acre). In the sale, the County acquired a portion of state trust land (14.33 acres) it had leased from the SLO under BL-629 since 1993. We identified the following deficiencies related to the sale.

Condition

Appraisal

Although the Commissioner conveyed 26.33 acres of state trust land in the final sale, the external appraisal the SLO utilized for this sale valued 19.88 acres of state trust land at $60,000, effectively $3,018 per acre, with an effective date of October 1, 2003. The appraisal notes an "inspection" date of March 16, 2007; however, during our examination we did not note any new comparisons of land value related to the four year lapse (October 2003 to March 2007) since the appraisal date. In addition, no SLO employee performed an in-house appraisal review of the external appraisal. The SLO did not have documentation that supports the adjustment of the application offer to the increased 26.33 acres at an effective $2,716 per acre.

The Commissioner appears to have arbitrarily allocated and valued the additional 6.45 acres (26.33 final acreage less 19.88 appraised) at $2,716 per acre without any kind of appraisal. Furthermore, it should be noted that the documentation indicated that the County offered $5,000 per acre in its application for 14.33 acres ($71,500 offer).

Lack of Financial Support for Values

The SLO field reviewer valued the 14.33 acres leased by the County under BL-629 at $469,326 ($32,751 per acre), and the SLO's in-house appraiser approved the field reviewer's valuation of the land in August of 2003 (two months before the external appraisal on the 19.88 acres). However, the Commissioner subsequently sold the leased land to the County at a value of $2,716 per acre. There is no documentation regarding the decrease in value of acreage from $32,751 per acre in 2003 to the final sale amount of $2,716 per acre.

It was also noted in the external appraisal and the closing sales agreement that the appraisal was conducted at the request of the County, not the Commissioner. However, the appraisal was performed almost three years before the County applied to purchase the land in 2006 and five years before the agreement was final. Another SLO field review in 2007 states the land (14.33 acres) should have been valued at $25,000 to $28,000 per acre. According to the SLO's valuation, at the final sales acreage the range of sales prices would have been $658,250 to $737,240.

Lack of Financial Analysis

The OSA did not locate a financial analysis or other supporting documentation that would support the Commissioner's execution of the sale. We did note that prior to the

sale an SLO Division Director questioned whether the trust would receive more revenue under a lease rather than the sale of the land. Upon the CRD's request for written feedback of this potential sale, the Oil, Gas and Mineral Resources Division Director indicated, "[w]ouldn't we make more long-term on a rental?" There was nothing in the sale file to show that the Division Director's inquiry was ever addressed or refuted by the Commissioner or other SLO staff.

Prior Business Lease Income and Forgone Payments

The Commissioner allowed the County to forgo rental payments, interest and penalty fees on the past due rent under business lease BL-629.

The set rent amounts under the lease for those years were as follows: 1993-1997, $3,865 per year; 1998-2002, $4,850 per year; and 2003-2007, $10,383 per year. As the sale closed in February of 2008, the SLO should have collected a total of $95,490 in rent payments during the applicable lease periods. However, the SLO only collected $53,275. Since the full amount was not collected as required by the contract, the Commissioner should have accrued interest charges and charged the County for the $42,215 due. A memo from the SLO to the County reveals that the "Commissioner has elected to charge for only one year at the old rate." Essentially, this allowed the County to pay only $4,850 (the former rent rate) of the total $42,215 due. The effective date of the lease relinquishment, February 2008, was the same date of the sale closing. Therefore, the lease was still active until February 2008.

There was also no evidence that the Commissioner ever charged the County interest on the delinquent rent payments. Those interest rates were set at one percent per month from the date of payment. As a result, the trust lost a minimum of $37,365 ($42,215-$4,850) in owed rent revenue and approximately $21,000 in interest payments, for a total of approximately $58,365.

To add to the inconsistencies already noted, the SLO field review notes that the County received approximately $35,000 a year in sub-lease revenue. It appears this sub-lease revenue alone could have provided the County the financial resources to pay the delinquent rent and interest owed to SLO.

Beneficiary Notification

The SLO failed to notify beneficiary institutions of the application to purchase the state trust land as required by SLO rules. There was no documentation in the sale file that supported the SLO advising the beneficiaries of the receipt of the application. In addition, the SLO sent the notice to the beneficiary in November 2009, more than a year after the sales transaction was closed. The beneficiary letter omits any disclosure of the relinquished lease revenue.

Criteria

As required by the Enabling Act and the Constitution of New Mexico, the Commissioner has a fiduciary duty to state trust land beneficiaries. All sales of trust land should benefit the trust beneficiaries and the SLO should have strong internal controls to ensure compliance with this duty. Rule 19.2.14.10(A) NMAC provides that the Commissioner

shall cause an appraisal of the land upon receipt of proper application to purchase and provide the appraisal to the applicant. Internal controls over trust land transactions require the use of financial analyses, timely appraisals and overall strong financial support in favor of the beneficiaries. Additionally, Rule 19.2.14.8(A) NMAC requires the SLO to advise the beneficiary institution upon receipt of any application to purchase. Such advisement should be transparent and include all aspects of the proposed transaction.

In the best interest of the trust, the Commissioner should uphold and adhere to business lease agreements. Paragraph 4 of BL-629 between the SLO and the County required interest on the delinquent rent payments accruing from the date the payment becomes due at the rate of one percent a month or for any fraction of a month. In general, lease revenue should benefit the trust beneficiaries, and penalties imposed upon a lessee for noncompliance with required lease payments protect the trust. The Commissioner's paramount duty, as trustee of state trust lands, is to manage the trust in the best interest of the trust beneficiaries, not the lessee.

Effect

The beneficiaries of the state trust land suffered a financial loss as a result of this transaction. In total, the loss equals land lease revenue relinquished in the amount of $10,388 a year, uncollected lease revenue of approximately $58,000 and a loss of 26 acres of trust land. Moreover, the untimely and undervalued appraisals may have resulted in significant undervaluing of land at the time of the sale. In addition, the SLO's own contractual business lease agreement terms were violated and the SLO failed to enforce them in the best interest of the trust. Overall, the entire transaction was not transparent to the public, the trust beneficiaries, and appears to not be in the best interest of the trust.

Cause

It does not appear that the SLO performed a financial analysis for this sale that could have been used to identify the lack of benefit to the trust. Internal controls related to statutes and administrative rules governing land sales are inconsistent, weak or altogether nonexistent. In addition, the undervaluing of the land was caused when the SLO arbitrarily increased the land conveyed without an appraisal to support it. Overall, there appears to be override of internal controls by the Commissioner.

Recommendation

The SLO should perform a financial analysis on all proposed sales in a consistent manner to ensure all pertinent financial aspects are considered by the Commissioner and his office. At a minimum, prior to relinquishing leases on land involved in a potential exchange, the SLO should analyze and compare the total lease revenue to the overall gain from the exchange. The SLO should utilize such analyses for each exchange and then retain the analyses as supporting documentation for the exchange.

In-house appraisal reviews and field reviews should be used consistently as one of the key components of SLO analyses of potential land sales, not only when they support the sale. If an in-house review or field review or other division feedback disagrees with the sale, there should be documentation to support how and why the transaction proceeded, including explanations that address any adverse reviews. In addition, the appraisals used should be timely. The Commissioner should adhere to terms of its contractual agreements, particularly when failure to enforce the terms results in a loss to the trust.

Finding 03 – Land Sale Not Executed in the Interest of the Trust

Final Sale Information

In November 2006, the Commissioner entered into an agreement with the City of Rio Rancho and Lions Gate Entertainment, Inc. for the sale of 40 acres of state trust land. The Commissioner did not offer the trust land for sale by public auction. Under the agreement, the Commissioner sold 40 acres of state trust land to the City of Rio Rancho for $1,408,000. The agreement then required the City to convey 7.12 acres of the land to Lions Gate at no cost and convey the remaining 32.88 acres to Lions Gate at the same price per acre as the City paid to the Commissioner.

The agreement also required the City and Lions Gate to enter into a "project agreement" whereby Lions Gate would be required to construct and operate a movie studio on the 7.12 acres of land. Under an ordinance passed pursuant to the Local Economic Development Act (LEDA), Sections 5-10-1 to 5-10-13 NMSA 1978, the City provided certain incentives to Lions Gate to build the movie studio on the 7.12 acres ("LEDA Land"). As further discussed below, the agreement also reserved certain rights and remedies for the Commissioner against Lions Gate if it failed to construct a movie studio on the LEDA land. We identified the following deficiencies related to the sale.

Condition

No Appraisal Supports the Value of State Trust Land Sold

The provisions of the sales agreement represented that an appraisal was conducted that appraised the 40 acres of trust land at $1,408,000 ($35,200 per acre). Although there was an external appraisal of the 40 acres conducted, the appraisal was appraised the trust land at $1,127,040 and was rejected by the SLO's in-house reviewer. We did not locate an appraisal that appraised the trust land at the value for which it was sold to Lions Gate. Rather, documentation in the sale file reflects that the SLO directly negotiated the trust land value with Lions Gate.

The external appraisal which valued the 40 acres of state trust land at $1,127,040 was conducted on April 28, 2006. The SLO in-house reviewer rejected the appraisal "for use by the Land Commissioner." The reviewer noted "the report's conclusion is significantly underestimated" and that "the report has varying defects which in of themselves singularly might not affect the result but in the aggregate discredit its use and minimize its credibility." Subsequently, in an email sent July 30, 2008 containing a "Checklist" on the "Rio Rancho Land Sale," and SLO employee informed an SLO Associate Counsel that "the value agreed upon yesterday between Lionsgate & SLO for the Rio Rancho Movie Studio" was $35,200 per acre. The email goes on to inquire, "[d]o we need a "Memo to the File" regarding the value since the value does not correspond with the appraisal?" There is no documentation in the file in response to the employee's inquiry. Additionally, there was no documentation in the file that would support $35,200 per acre as the true value of the trust land.

Given these facts, the provisions of the sales agreement misrepresent that an appraisal was conducted that appraised the land at $35,200 per acre. Section 1.3 of the sales

agreement provides that the City of Rio Rancho engaged a licensed appraiser to conduct an appraisal of the 40 acres of trust land. That section also provides the following: "After inspection of the subject State Trust Land and review of the appraisal, the Commissioner has concluded that the value of the subject State Trust Land shown in the appraisal . . . is the true value of said land." The agreement shows the value of the trust land, and the sales price, as $1,408,000 ($35,200 per acre).

Public Auction Requirement Appears to Have Been Circumvented

The sale of the 40 acres of trust land was not offered by the Commissioner for sale to the highest and best bidder at public auction. In the sales agreement, the Commissioner conveyed the trust land to the City of Rio Rancho – a government transaction for which a public auction process is not required. The agreement then required the City to convey 7.12 acres of the land to Lions Gate at no cost and convey the remaining 32.88 acres to Lions Gate at the same price per acre as the City paid to the Commissioner.

The agreement states that "the Commissioner has determined that public notice offering the subject State Trust Land for sale and public auction thereof is not required by the Enabling Act." However, documentation in the sales file indicates that the SLO directly negotiated the sales price of $1,408,000 for 40 acres of trust land with Lions Gate, not the City of Rio Rancho. As explained above, we did not locate an appraisal that appraised the trust land at the value for which it was sold to Lions Gate, and the SLO and Lions Gate separately negotiated a sales price. The Commissioner appears to have given preferential treatment to Lions Gate and the public bidding process appears to have been circumvented to execute the land sale.

Improper Improvement Value Credit Calculation

Prior to the sale by the Commissioner, the 40 acres of trust land were a portion of 439 acres of trust land leased by a private developer under planning and development lease BL-1713. The lease, executed in 2005, required lease payments of $5,000 per year and entitled the developer to an improvement value credit (IVC) upon the subsequent sale of the land leased. Upon the sale of the land to Lions Gate, the lessee relinquished lease rights to the 40 acres and continued to lease under BL-1713. Of the total sales proceeds of $1,408,000 for the 40 acres, the developer received $305,982.88 for the IVC and the developer's "reasonable project costs." The trust received the remainder, $1,102,017. In violation of the lease terms, the SLO improperly calculated the IVC for two reasons. First, the only appraisal of the trust land conducted appraised the land's value at $1,127,040, which the SLO did not use in calculating the IVC. Second, we did not locate an appraisal that appraised the trust land at the value for which it was sold to Lions Gate, and the SLO and Lions Gate separately negotiated a sales price. Absent an appraisal of the land, the SLO improperly used the *sales price* instead of the appraised value to calculate the IVC.

The lease agreement's IVC provided that the developer would receive payment in the amount of 40% of the "change in value" of the trust land ultimately sold, plus payment of the developer's "reasonable project costs." The lease indicated the "Change in Value" is the difference between the appraised value of the land near the beginning of the lease term and the appraised value of the land near the end of the lease term. Therefore, the

"Base Value" of the land near the beginning of the lease term is established in the "First Appraisal Round," and the "Final Value" of the land near the end of the lease term is established in the "Second Appraisal Round."

We also noted that the appraisal related to the "First Appraisal Round" under the lease was rejected by the SLO in-house appraiser; yet, it was still used by the Commissioner as the "Base Value" of the land when calculating the IVC. Moreover, the SLO did not use the "Final Value" established by the "Second Appraisal Round" when calculating the IVC for the developer. As noted above, the only appraisal conducted appraised the value of the trust land at $1,127,040 and was rejected by the SLO's in-house reviewer. Instead, the SLO improperly used the *sales price*, not the appraised value, of the land to calculate the IVC. If the appraised value of $1,127,040 had been used as the "Final Value" to calculate the IVC, the developer would have only received $184,624 in IVC payment. The SLO's use of the sales price resulted in the Commissioner disbursing $297,000, plus $8,982.88 in "project costs," to the developer. In any case, the SLO violated the terms of the lease by failing to use an appraisal for the "Final Value" component of the IVC calculation which may have resulted in an overpayment or underpayment to the developer. There was also no documentation noted in the file that would support or detail the $8,982.88 in "reasonable project costs" disbursed to the developer.

Contractual Obligations of Lions Gate and Termination of Agreement

The original sales agreement reserved certain rights and remedies for the Commissioner against Lions Gate if it failed to construct a movie studio on 7.12 acres of the land sold (LEDA land). Lions Gate ultimately failed to meet its contractual obligations to construct a movie studio; however, the Commissioner did not pursue any rights and remedies against Lions Gate as provided in the original agreement.

The sales agreement provided that Lions Gate received the LEDA land at *no cost* from the City of Rio Rancho. However, the agreement contained provisions that required Lions Gate to pay "contingent consideration" to the Commissioner for the LEDA land if it failed to construct a movie studio on the land and meet other economic development goals. Should Lions Gate fail to meet these obligations, the agreement provided that Lions Gate "shall be required to pay the Commissioner the amount of $75,000.00 per acre for the actual acreage of the '7.12 acre studio portion' reflected on the Survey of the LEDA land, plus interest at the rate of five percent (5%) per year from Closing through the date of such termination." In addition, the Commissioner secured a mortgage on the LEDA land to ensure payment of the contingent consideration by Lions Gate. In November 2006, the Commissioner and the City entered into a separate agreement which provided that, in the event of contingent consideration payment by Lions Gate, the City was to receive $35,200 per acre plus interest of the total $75,000 to be paid to the Commissioner, which amounts to 46.93% of the contingency.

Three years after execution of the original sales agreement, Lions Gate failed to construct a movie studio and meet other requirements as set forth in the agreement. The Commissioner did not pursue payment of the contingent consideration by Lions Gate. According to a memorandum from the SLO's General Counsel, the Commissioner "wanted to sever ties with lionsgate permanently and the Office of General Counsel

advised that the most expeditious way to accomplish that severance was a termination agreement and re-deed" of the LEDA land. Therefore, on November 23, 2009, the Commissioner and Lion's Gate executed a termination agreement in which Lions Gate was allowed to re-deed the LEDA land back to the SLO. Lions Gate was released from the mortgage on the property, owed no payment of contingent consideration and Lions Gate's obligations under the original sales agreement were "deemed satisfied by the Commissioner."

If the Commissioner had enforced payment of the contingent consideration provision of the original sales agreement, the SLO had a contractual right to receive $618,172 (75,000*7.12 acres plus 5% of the total due for each three years) from Lions Gate. Pursuant to the November 2006 agreement between the Commissioner and the City, $290,108 of the contingent consideration would have been distributed to the City and SLO would have retained $328,064. The contingent consideration provisions were touted in the SLO's notice to beneficiaries about the sale. In sum, despite its failure to meet its contractual obligations, Lions Gate was simply allowed by the Commissioner to give back the 7.12 acres of land which it never paid for in the first place. Furthermore, the termination agreement provided that the Commissioner and the City would divide and replat the 7.12 acres. Therefore, in the end, the City was entitled to 3.34 acres of the total 7.12 acres, while the SLO was entitled to 3.78 acres.

The termination agreement between the SLO and Lions Gate also did not impact the remaining 32.88 acres of land conveyed to Lion's Gate under the original sales agreement. Lions Gate was allowed to keep the land, even though the purpose of the sale was the construction of a movie studio.

Beneficiary Notification

The SLO failed to notify beneficiary institutions of the application to purchase the state trust land as required by SLO rules. There was no documentation in the sale file that supported the SLO advising the beneficiaries of the receipt of the application. In addition, the SLO sent the beneficiary notification on November 15, 2006, months after the sales agreement date of August 10, 2006. It also contains the following misleading language: "the permanent fund would be increased by the $1,408,000 in payment for the land." However, the permanent fund did not receive $1,408,000. Nowhere does the beneficiary notice reveal the amount the trust actually received, which was $1,102,018. The private developer under planning and development business lease BL-1713 received the remainder of the sales proceeds in the amount of $305,982 because of an IVC and reimbursement for reasonable project costs. The beneficiary notice also erroneously indicates "none" with regard to current lease income, when in fact the 40 acres sold were previously included in the trust lands leased by the Commissioner under BL-1713 for $5,000 per year.

Criteria

As required by the Enabling Act and the Constitution of New Mexico, the Commissioner has a fiduciary duty to state trust land beneficiaries. All sales of trust land should benefit the trust beneficiaries and the SLO should have strong internal controls to ensure

compliance with this duty. Section 10 of the Enabling Act requires that trust lands be "appraised" and disposed of "at their true value." Rule 19.2.14.10(A) NMAC provides that the Commissioner shall cause an appraisal of the land upon receipt of proper application to purchase and provide the appraisal to the applicant. Furthermore, the planning and development lease requires that the IVC calculation be derived from the appraised values of the trust land.

As part of its internal control process, the SLO's in-house appraiser reviews appraisals of the state trust land for reasonableness, accuracy and compliance with professional appraisal standards (USPAP), and submits his or her findings and recommendations in a review report to the Commissioner. Established controls, such as in-house appraisal reviews, should not be overridden without justifiable supporting cause.

Section 10 of the Enabling Act requires that trust lands cannot "be sold . . . except to the highest and best bidder at a public auction." Rules 19.2.14.11through 13 NMAC contain the requirements to advertise trust land sales, qualify bidders and sell trust lands to the highest and best bidder at public auction.

Additionally, Rule 19.2.14.8(A) NMAC requires the SLO to advise the beneficiary institution upon receipt of any application to purchase trust lands. Such advisement should be transparent and include all aspects of the proposed transaction, such as the actual amount of sales proceeds received.

Effect

The failure to use an acceptable appraisal of the trust land sold may have violated the Enabling Act and resulted in a financial loss for trust beneficiaries. The trust may not have received the "true value" for the land sold if the Commissioner failed to use an acceptable and appropriate appraisal to determine the true value of the land. The public auction requirements of the Enabling Act also may have been circumvented. Additionally, a financial loss to the trust may have occurred due to the improper IVC calculation and disbursement to the developer. The trust beneficiaries also may have suffered a financial loss due to the termination agreement which waived Lions Gate's obligation to pay contingent consideration. Finally, the lease's misrepresentations regarding the appraised value of the land, coupled with the SLO's failure to properly and accurately notify trust beneficiaries, contributed to the overall lack of transparency in the transaction. In sum, the sale did not appear to be executed in the best interest of the trust.

Cause

After an appraisal of the land was rejected by SLO's in-house reviewer, the Commissioner failed to cause an appraisal of the land in order to determine its true value. The Commissioner also allowed an improper IVC to be paid to the developer and terminated Lions Gate's original contractual obligation to pay contingent consideration. The cause appears to be lack of or improper internal controls related to land sales and an override of internal controls by the Commissioner.

Recommendation

The Commissioner has a fiduciary responsibility to the beneficiaries of state trust land and should take the greatest of care when determining whether or not certain transactions are in the best interest of the trust. The Commissioner should strictly adhere to the Enabling Act's requirements that trust lands be "appraised" and disposed of "at their true value." The Commissioner should ensure the trust is fully compensated for the sale of trust lands by using acceptable and appropriate appraisals to determine the true value of those trust lands. In-house appraisal reviews should be consistently used as one of the key internal control components related to land sales. If an in-house review rejects an appraisal for use, another appraisal of the trust land should be conducted and used to determine the land's true value. Moreover, any circumvention of the Enabling Act's public auction requirements compromises the trust and harms transparency and public confidence in the proper management of state trust lands.

The Commissioner should also comply with SLO rules and SLO contractual provisions when managing transactions involving state trust land. The rules and requirements help protect and benefit the trust and the related sale of trust land. IVCs should be calculated and distributed as provided in the lease agreements, and the Commissioner should always use acceptable appraisals to determine the IVC split amount paid to private developers. The SLO should also enforce contractual provisions when in the best interest of the trust.

The SLO should strictly adhere to the requirements of Rule 19.2.14.8(A) NMAC. Beneficiaries should be informed in a timely manner of applications to purchase state trust land. Compliance will ensure protection of the trust and create greater transparency in the potential sale of state trust lands. Additionally, beneficiary notices should accurately include all elements of the proposed sale, such as the final sales proceeds, the IVC amount disbursed to a developer, the amount retained by the trust and any related relinquished lease revenue. In addition, as part of the Commissioner's fiduciary duty, the beneficiaries should be notified when a transaction or parts of a transaction are terminated or changed from the original agreement. Such notice should disclose the final impact to the trust beneficiaries.

Finding 04 – True Value of Land Not Reflected in Land Exchanges

Condition

During our test work of land exchanges, we noted certain transactions in which the trust did not appear to receive the "true value" for trust lands conveyed to an exchange party due to the SLO's lack or inconsistent application of an objective, reliable and commercially acceptable method to determine the true value. Outlined below are the examples of this condition:

1) A certified appraiser appraised the value of private land acreage proposed for an exchange. Ultimately, the SLO increased the private land acreage received by the SLO in the final transaction, but the SLO simply applied the same value per acre from the appraisal on the initial acreage to the extra acreage upon closing the transaction. We did not locate documentation in the file that indicated the additional acreage was inspected by an appraiser or SLO personnel who are certified to verify that the value of the additional acreage was similar to the acreage included in the certified appraisal. There was also no documentation of some other kind of objective, reliable and commercially acceptable method to determine the true value of the additional acreage. Therefore, we were unable to determine that the trust received the true value for the land exchanged in certain transactions, since it does not appear the SLO used an objective, reliable and commercially acceptable method to determine the true value.

   For instance, in one exchange tested (test item 10 in table below), private land of approximately 6,500 acres was appraised by a certified appraiser at $950,000. Yet, the final transaction resulted in 7,200 private acreage conveyed to the trust at a value of $1,042,655 without any appraisal on the final acreage. There was no documentation located in the file that supported or explained the increase in acreage and applied value. We noted multiple exchange transactions similar to this exchange (noted in table below as test items 4 and 6).

2) A certified appraiser appraised the value of trust and private land acreage proposed for an exchange. Ultimately, the SLO decreased either the trust or private land acreage exchanged in the final transaction, but the SLO simply applied the same value per acre from the appraisal on the initial acreage to the decreased acreage upon closing the transaction. We did not locate documentation in the file that indicated the reduced acreage was inspected by an appraiser or SLO personnel who are certified personnel to verify that the reduced acreage was similar to the acreage included in the certified appraisal. There was also no documentation of some other kind of objective, reliable and commercially acceptable method to determine the true value of the decreased acreage. Therefore, we were unable to determine that the trust received the true value for the land exchanged in certain transactions, since it does not appear the SLO used an objective, reliable and commercially acceptable method to determine the true value. See items 2 and 3 in the table below.

3) We noted multiple exchanges where the certified appraised value was not the amount that was reflected in the final transaction. The final value of land and appraised acreage to be exchanged was either increased or decreased by SLO personnel who were not certified appraisers. See items 1, 5, 7, 8 and 9 in the table below.

   In one exchange, an appraisal performed by an external certified appraiser resulted in an appraised value of state trust land of 15 acres at $4,500 per acre. Yet, the final transaction resulted in 30.07 acres conveyed to the private party valued at $7,500 per acre. There was no documentation in the folder that explained or supported how the initial 15 acres of state land increased to 30.07 acres in the final exchange. Documentation in the file also showed that a SLO employee who is not a certified appraiser arbitrarily increased the appraised value of the land. See Item 9 in the table below or Finding 01 for further detail of this exchange.

4) We also observed five appraisals, some as old as three years old at the time of the transaction, in which no support was identified that the lapse of time was reasonable considering the "true value" requirement. We did not identify any support which indicated that the "true value" of the property was reassessed, updated, or inspected upon or near the closing of the exchange transaction.

Refer to Numbers 1-3 of the Condition above for test items contained in the table.

Test item	**Appraised acreage and value by certified appraiser**	**Amount of acreage and value exchanged in final transaction**	**Variance in acreage and/or value compared to certified appraisal**
1. Trust land/one of four parcels	275.73 acres for $270,000 or $980/acre	301.52 acres for $450,000 or $1,492/acre	25.79 acres more were exchanged and the value increased by $512/acre
2. Private land	4,973.72 acres for $5,100,000 or $1,025/acre	1,195.1 acres for $1,225,443.50 or $1,025/acre	3,778.62 acres less were exchanged, no difference in value per acre
3. Trust land	6,452.53 acres for $807,000 or $125/acre	5,988 acres for $749,000 or $125/acre	464 acres less were exchanged, no difference in value per acre
4. Private land	3,483 acres for $766,000 or $220/acre	3,548 acres for $781,000 or $220/acre	65 acres more were exchanged, no difference in value per acre
5.	5,000 acres for	6,351.92 acres for	1,351.92 acres more were

Private land	$2,000,000 or $400/acre	$2,502,656.48 or $394/acre	received and the value per acre was decreased by $6/acre
6. Private land, first track	1,341.12 for $1,475,000 or $1,100/acre	1,650.73 acres for $1,815,803 or $1,100/acre	309.61 acres more were received, no change in value per acre
7. Private land, second track	9,170 acres for $2,200,000 or $240/acre	8,582.12 acres for $1,716,424 or $200/acre	587.88 acres less were received, valued $40 less per acre
8. Private land	8,560 acres for $1,718,000 or $201/acre	9,228.25 acres for $1,717,477 or $186/acre	668.25 acres more were received, valued $15 less per acre
9. Trust Land	15 acres for $4,500/acre	30 acres for $225,000 or $7,500/acre	15 more acres were exchanged at $3,000 more an acre
10. Private Land	6,567 acres for $950,000 or $144/acre	7,207 acres for $1,042,655 or $144/acre	640 more acres exchanged, no change in value per acre

Criteria

As required by the Enabling Act and the Constitution of New Mexico, the Commissioner has a fiduciary duty to state trust land beneficiaries. Section 10 of the Enabling Act requires that that trust lands be "appraised" and disposed of "at their true value." Rule 19.2.21.8(C) NMAC provides that "[i]n any exchange, the trust must receive at least true value for the trust lands that are conveyed to an exchange party." Rule 19.2.21.7(R) NMAC defines "true value" as "fair market value as determined by any objective, reliable and commercially acceptable method including but not necessarily limited to appraisal by an appraiser."

Cause

Because the Commissioner is the final approval on all land sales, exchanges, and leases, the cause appears to be override of controls by the Commissioner.

Effect

The exchanges do not appear to have been in the best interest of the trust beneficiaries as the exchanges were not executed based on the true value of the land. As a result of these transactions, there may have been a financial loss to the trust.

Recommendation

The Commissioner has a fiduciary responsibility to the beneficiaries of the trust land. Accordingly, the Commissioner and SLO staff should exact great care when determining the true value of land to ensure that the trust receives at least true value for the trust lands that are conveyed to an exchange party. The SLO should implement controls to ensure the use of objective, reliable and commercially acceptable methods of determining the true value of trust lands subject to exchange. The SLO should maintain documentation regarding any increases or decreases to appraised amounts and quantities of land acreage. Changes to original appraised values and acres should be thoroughly documented in order to properly support and meet the true value definition of the lands being exchanged. Modifications to values and land acreage should not be made by SLO employees arbitrarily or by SLO employees who are not certified appraisers. The Commissioner also should not sanction these types of arbitrary modifications. Furthermore, only an objective, reliable and commercially acceptable method should be used to determine the true value of trust lands.

The Commissioner should ensure that the true value of trust lands is accurate at the time of the exchange. Appraisals should be reevaluated to reflect up-to-date comparable sales or other reasonable factors of the current market at the time of the exchange. This updated assessment should be retained to reflect the true value of the land. In addition, the SLO should consider implementing written policies regarding the procedures to be performed relative to the use and effectiveness of appraisals.

Finding 05 – Appraisal Review Omission

Condition

Eighteen of the SLO appraisal review reports scrutinized during the course of this engagement have omitted the certification that the review appraiser has no bias with respect to the property that is the subject of the work under review.

Criteria

The Uniform Standards of Professional Appraisal Practice (USPAP) establish the requirements for developing appraisals and the process by which appraisals are to be reviewed. Each appraisal review report rendered by the SLO review appraiser includes a statement to the effect that "[t]he report that follows presents the pertinent facts and analyses derived from my review in compliance with Standard 3 of the USPAP." Standard 3 of USPAP includes Standards Rule 3-3, which requires each appraisal review report to include a signed certification that includes nine criteria. One of those criteria includes the following phrase: "I have no bias with respect to the property that is the subject of the work under review."

Cause

The SLO review appraiser developed the template for his appraisal review reports after referring to Section 3 of the USPAP. He wanted to make his reports less verbose by editing and simplifying some of the "boiler plate" included in Section 3 of USPAP.

Effect

Omission of the certification that the review appraiser has no bias with respect to the property could create the perception that SLO's review appraiser was not following all of the guidance included in the USPAP.

Recommendation

The SLO's template for appraisal review reports needs to be updated to include certification that the review appraiser has no bias with respect to the property that is the subject of the work under review. All established standards in the appraisal process should be followed in their entirety to provide for the ultimate benefit to the trust beneficiaries.

Finding 06 – Proposed Exchange with Unsupported Values

Condition

The SLO arbitrarily changed the per acre appraisal value on a tract of land involved in land exchanges in the White's Peak area from $400 per acre to $404 per acre.

Tract O-5, owned by UU Bar Ranch, was originally presented to include 2,870.19 acres of land in Mora County. This tract was appraised by an external appraiser at $400 per acre for a total of $1,148,000. However, a survey of the land disclosed the tract only included 2,844.14 acres. The SLO raised the value per acre to $404 from the appraisal value of $400, thus maintaining the value for the tract at $1,148,000. The reviewers did not locate any documentation in the SLO files justifying this increase in the value per acre.

Criteria

The Uniform Standards of Professional Appraisal Practice (USPAP) establish the requirements for appraising real estate, and the SLO incorporates these standards into their appraisal engagement letters with external appraisers. Standard 1 of USPAP establishes the guidelines for developing the appraisal – from planning the appraisal and selecting the appropriate methods and techniques that are necessary, to collecting, verifying, and analyzing all information necessary for credible assignment results. Standard 2 establishes the guidelines for reporting on the appraisal conducted and requires the appraiser to communicate each analysis, opinion, and conclusion in a manner that is not misleading. USPAP includes a series of questions and answers related to the USPAP Ethics Rule for appraisers. Item 15, "Using a Flawed Appraisal Report" states that while it is not unethical for an appraiser to read another appraiser's flawed report, it is unethical to use it.

Section 10 of the Enabling Act requires that that trust lands be "appraised" and disposed of "at their true value." In addition, all values of land to be exchanged, whether trust land or private land, should be determined in accordance with SLO rules. Rule 19.2.21.7(R) NMAC defines "true value" as "fair market value as determined by any objective, reliable and commercially acceptable method including but not necessarily limited to appraisal by an appraiser." Rule 19.2.21.8(C) NMAC provides that "[i]n any exchange, the trust must receive at least true value for the trust lands that are conveyed to an exchange party."

Effect

If this exchange is consummated without change, the SLO's arbitrary adjustment in the value of the land will result in a loss of $10,344 to the trust beneficiaries. The appraiser's value per acre of $400 multiplied by 2,844.14 acres, the correct acreage, renders a value of $1,137,656 for Tract O-5 If this value is used in place of the $1,148,000 value developed with the incorrect acreage, it results in the value of all the land offered by UU Bar Ranch to be $2,372,656, which is $10,344 less than the appraised value of the state trust lands proposed to be exchanged to UU Bar Ranch.

Cause

The SLO failed to have the external appraiser render a corrected appraisal report based on the correct acreage for Tract O-5. Instead, the SLO arbitrarily raised the value per acre from $400 to $404 in order to maintain the value of the tract at $1,148,000.

Recommendation

The SLO should not arbitrarily change the value of land in any transaction. The Commissioner should have rejected the appraisal based on incorrect acreage and should have sought a new appraisal based on the correct acreage. Further, SLO staff should adhere to the USPAP Ethics Rule and not use an appraisal report that it knows to be flawed.

The trust is compromised when the Commissioner fails to use an objective, reliable and commercially acceptable method to determine the true value of trust lands involved in an exchange. SLO employees should not alter the value of land without cause, proper support, or the use of an objective, reliable and commercially acceptable method to determine the true value. Moreover, the Commissioner should not approve SLO employees' action that fail to meet this requirement for determining "true value."

The acreage offered by UU Bar Ranch should be increased or the acreage offered by the Commissioner should be decreased to provide the trust beneficiaries with a gain rather than a loss from this exchange.

Finding 07 – Appraisal Accepted from an Appraiser with Expired License

Condition

The SLO accepted an appraisal prepared by an individual who was not licensed to appraise real estate in New Mexico when the individual began the appraisal.

The appraiser obtained a temporary practice permit to appraise land in New Mexico pursuant to Section 61-30-21 NMSA 1978. The temporary practice permit was issued effective September 10, 2008 with an expiration date of March 10, 2009. Prior to the September 10, 2008 temporary license, the appraiser's last record of active licensure reveals an issue date of April 23, 2007 and an expiration date of October 23, 2007. There was no record that the appraiser was licensed in New Mexico from October 24, 2007 to September 10, 2008. The appraiser's appraisals of both the trust lands and the private land offered in the UU Bar Ranch land exchange (White's Peak area) are dated effective September 9, 2008. The appraiser's appraisals of both the trust lands and the private land offered in the Elk Ridge/William Galloway land exchange are dated effective September 8, 2008. Since the effective dates of these appraisals are before the permit to practice was obtained, it can be assumed some of the appraisal work was done without proper licensing. Despite the obvious license lapse, the Commissioner allowed the appraisal to be used.

Criteria

Section 61-30-4(A) NMSA 1978 provides the following: "It is unlawful for any person in this state to engage or attempt to engage in the business of developing or communicating real estate appraisals or appraisal reports without first . . . obtaining a license or certificate from the [Real Estate Appraisers Board] under the provisions of the Real Estate Appraisers Act" (REAA), Chapter 61, Article 30 NMSA 1978. Furthermore, Rule 16.62.10.8(A) NMAC, promulgated pursuant to the REAA, provides that "[a]ll persons who engage in the business of, act in the capacity of, advertise or display in any manner or otherwise assume to engage in the business of, or act as, a state real estate appraiser must have a board license or permit." Lastly, Rule 16.62.10.8(B) provides that "[a] temporary permit may be issued to non-resident appraiser licensed and certified appraiser for the purpose of performing an appraisal or appraisal review."

Section 61-30-22 NMSA 1978 provides certain criminal and civil penalties for violating the provisions of the REAA. Any person who violates any provision of the REAA is guilty of a misdemeanor. The attorney general or the district attorney of the judicial district in which the violation occurred shall, upon application of the Board, maintain an action in the name of the State to prosecute the violation. The Board also may impose a civil penalty in an amount not to exceed $1,000 for each violation of the REAA.

Cause

It appears the appraiser began working in New Mexico prior to being licensed pursuant to the REAA. The SLO's review of the appraisal either omitted or overlooked the lapse in licensing.

Effect

The appraiser appears to have violated the REAA. The SLO formally used an appraisal that was in violation of statutory and regulatory requirements. State trust land beneficiaries were not provided with proper care over state trust lands as the transaction was not completed with proper internal controls to identify appraisal non-compliance.

Recommendation

The SLO should have controls in place that would prevent the hiring of an out-of-state appraiser until the appraiser's permit to practice in New Mexico has become effective. Work should not begin until after the permit is effective. The SLO must perform a quality review on appraisals and the appraisers who perform the work. Furthermore, the SLO should consider adding verbiage that addresses New Mexico licensing requirements to its "Standard Criteria for Appraisals" which is included in the bid packet for land exchanges.

Finding 08 – Lack of Support for Material Benefit to Trust

Condition

During our test work of land exchanges, we noted a trend among certain sampled items in which the documentation provided by the SLO did not appear to support the regulatory objective of land exchanges, which is that the exchange will result in a material benefit to the trust. The large majority of the exchanges resulted in a net loss of acreage to the trust for a small financial gain.

The following table depicts the identified exchanges (by detail of the transaction) that do not appear to have been in the best interest of the trust. Explanations regarding each test item immediately follow the table.

Test item	State trust land acreage conveyed to private party and appraised value	Private land acreage conveyed to state trust and appraised value	Monetary gain	Net gain (loss) of state trust acreage
1.	280 acres at $5,600	160 acres at $5,600	$5,000 – cash bonus paid by private party	(120) acres
2.	760 acres at $114,000	760 acres at $114,000	$29,606 – cash bonus paid by private party	0
3.	640 acres at $384,000	65 acres at $520,000	$136,000-gain in land value (no cash)	(575) acres
4.	5,988 acres at $749,000	3,548 at $781,000	$32,000-gain in land value, $21,000 bonus to the permanent fund	(2,440) acres
5.	736 acres at $165,000	41 acres at $144,000	$5,000 – cash bonus ($21,000 was paid in cash to reach equal value due to appraisal variance)	(695) acres
6.	7,205 acres at $6,356,000	3,330 acres at $6,413,000	The $57,000 gain in value of land may be inaccurate. Any real gain depends on appraisals.	(3,875)
7.	3,431 acres at $2,381,000	3,584 acres at $2,383,000	The $2,000 gain is less than 1/10 of 1% margin. This leaves no room for error in the appraisals.	153

Test item 1 reveals that the exchange resulted in a loss of 120 acres of state trust land essentially in exchange for an additional cash bonus of $5,000 paid by the private party. In addition, the SLO noted that the land it conveyed has high potential for oil and gas; yet by conveying the surface rights, it creates a split estate. The split estate creates a poor situation for generating future mineral lease revenue. Split estates significantly reduce the SLO's opportunity to secure mineral leases since the surface rights are owned by a private party. We also noted that the SLO acknowledged in the beneficiary notification that the offered land would not be transferring the oil and gas mineral rights. In essence, the trust lost surface rights in which they retained mineral rights, and the land received was void of any mineral rights to compensate for the loss. It is recognized that mineral leases bring in substantial revenue.

Test item 2 reveals that the exchange resulted in an equal trade of acreage and value of state trust land, even though the appraisal was not in compliance with USPAP standards as noted by the SLO's in-house appraiser (see Finding 10). In addition, SLO noted that the land it conveyed has high potential for oil and gas; yet by conveying the surface rights, it creates a split estate. As previously mentioned, the split estate significantly reduces the SLO's opportunity to secure mineral leases since the surface rights are owned by a private party. In addition, the SLO did not conduct an updated financial analysis for the land traded in this particular exchange. In the initial application, which requested 160 more acres of trust land (920 in total), the SLO noted a net loss of grazing lease revenue should the exchange be consummated. Yet, despite this analysis, upon the final exchange amount of 760 acres the SLO did not conduct a financial analysis. Without the financial analysis, the SLO reviewer, and consequently the Commissioner, cannot determine whether the exchange would truly benefit the trust.

Test item 3 reveals that the exchange resulted in a net loss of 575 acres of state trust land in exchange for a $136,000 extra land value (no cash was received). In addition, the SLO noted that the land it conveyed is underlain by 6 to 12 feet of good quality limestone; however, by conveying the surface rights, it creates a split estate that complicates any future mining development on this site because quarry operations require extensive use of the site surface. We also noted that the SLO acknowledged the offered land would not be transferring the mineral rights. Once again, the trust retained mineral rights, but lost surface rights and will lose potential royalties from this site.

Test item 4 reveals that the exchange resulted in a net loss of 2,440 acres of state trust land essentially in exchange for $53,000, an amount which was partially a cash bonus paid by the private party and partially extra land value. Relative to this exchange, the SLO noted that the oil, gas, and geothermal potential is classified as moderate on the land it conveyed; yet by conveying the surface rights, it creates a split estate. We also noted that the SLO acknowledged the offered land would not be transferring the oil and gas mineral rights. Once more, the trust retained mineral rights but lost surface rights, and the land received was void of any mineral rights to compensate for the loss. It is recognized that mineral leases bring in substantial revenue.

Test item 5 reveals that the exchange resulted in a net loss of 695 acres of state trust land. In fact, the amount of private acreage conveyed to the SLO was of less value than the trust land by an amount of $21,000. Though the private exchange party paid the $21,000

at closing, the only cash the SLO received for the exchange was $5,000. The net impact was that the trust lost 695 acres for $5,000.

Test item 6 reveals that the exchange resulted in a net loss of 3,875 acres of state trust land. The increase in value of the land held by the trust of $57,000 may be inaccurate as this number is highly dependent on the appraisals of the land exchanged. If any of the appraisals in this exchange inaccurately placed too high of a value on the subject land, the $57,000 gain could be reduced or perhaps be changed into a loss (See Finding 13). An SLO District Resource Manager memorandum dated December 20, 2007 noted that in the proposed exchange "approximate acreage of private land offered is 3,863 acres while approximately 6,374 acres of State Trust Land is requested for exchange." Had this exchange been finalized with those acreage amounts, the loss in acreage would only have been 2,511 acres.

Test item 7 reveals that this proposed exchange will result in a net gain of 153 acres of state trust land. Again, the increase in value of the land held by the trust of $2,000 may be inaccurate as this number is highly dependent on appraisals. If any of the appraisals in this exchange inaccurately placed too high of a value on the subject land, the $2,000 gain could be reduced or perhaps be changed into a loss. A gain in value of $2,000 on an exchange where lands exchanged and received are both valued at over $2.3 million is less than 1/10 of 1% gain. In addition, one of the appraisals of land offered by UU Bar Ranch was based on incorrect acreage. If this exchange is allowed to proceed without any modification, the trust beneficiaries will incur a loss of $10,344. See Finding 06 for additional detail regarding this transaction.

Criteria

Rule 19.2.21.6 NMAC provides that it is the objective of SLO administrative rules governing land exchanges "to provide for the orderly and lawful exchange of trust lands when such exchanges will result in a material benefit to the trust not otherwise available, and when the exchange of such trust lands would benefit the trust more than their retention." Moreover, Rule 19.2.21.8(A) provides that the "commissioner may enter into an exchange when the commissioner determines that the exchange will result in a material benefit to the trust and the purpose of the exchange would serve the best interests of the trust."

Section 10 of the Enabling Act requires that that trust lands be "appraised" and disposed of "at their true value." In addition, all values of land to be exchanged, whether trust land or private land, should be determined in accordance with SLO rules. Rule 19.2.21.7(R) NMAC defines "true value" as "fair market value as determined by any objective, reliable and commercially acceptable method including but not necessarily limited to appraisal by an appraiser." Rule 19.2.21.8(C) NMAC provides that "[i]n any exchange, the trust must receive at least true value for the trust lands that are conveyed to an exchange party."

Cause

It appears that the SLO does not consistently adhere to the requirements of its administrative rules when administering land exchanges.

Effect

The trust beneficiaries do not appear to be deriving much, if any, benefit from some of the land exchanges. As a result of these transactions, there may have been a financial loss to the trust.

Recommendation

The Commissioner has a unique and vital fiduciary duty to the trust; therefore, the SLO should ensure with the utmost care that each exchange will be in the best interest of the trust by resulting in a material benefit. Procedures should be in place to fully identify all aspects of the exchange, diligently weigh the pros and cons, and then use the identified factors to support or reject the exchange. Every step in the decision making process should be documented to support the transaction and to convey transparency. Financial analyses are a key component in the decision making process and therefore, should be completed and retained for each and every proposed exchange.

The SLO has demonstrated in some other land exchanges we reviewed that it can advocate for the trust and produce verifiable gains for the trust. This type of zealous advocacy for trust beneficiaries should be carried out by the SLO in all exchanges.

Finding 09 – Planning and Development Lease Payments Not Collected

Condition

During our review of planning and development business leases we noted two leases, BL-1775 and BL-1776, in which payments to the SLO were not current. In the first lease, BL-1775, the lease agreement requires the lessee to pay annual rent to the SLO in the amount of $37,500. After review of the SLO's ONGARD system, we found that the lessee made only a year and a half's worth of payments. As of August 2010, the SLO should have collected over $112,500 in payments since in the lease began in January 2007. However, the SLO has collected only $56,437. Additionally, there is no record of penalty or interest being accrued and charged as required by the lease. There is also no record that the SLO has relinquished this lease. As of August 2010, over $178,125 is due from the lessee in the form of past due lease payments and accrued interest and fees.

In the second lease, BL-1776, the lease agreement requires the lessee to pay annual rent to the SLO in the amount of $20,000. As of August 2010, the SLO should have collected over $60,000 in payments since the lease began in January 2007. However, the SLO has collected only $20,666, just over a year's worth of payments. Additionally, there is no record of penalty or interest being accrued and charged, as required by the lease. There is also no record that the SLO has relinquished this lease. As of August 2010, over $157,850 is due from the lessee in the form of past due lease payments and accrued interest and fees.

Criteria

Section 19-1-3 NMSA 1978 provides the following: "When entering into contracts for the sale, lease or other disposition of public lands under his jurisdiction, the commissioner of public lands is authorized to contract for payment of interest on any payment of rental, royalty, principal interest or other indebtedness which becomes delinquent." Rule 19.2.9.12(E) NMAC states that unless otherwise provided in a lease, rent shall be paid in advance in annual installments. Section 9.1 of each lease agreement requires rent will be payable in quarterly installments and will be due on the first day of the calendar quarter, except the rental payment for the initial quarter will be due at the signing of the Lease. Section 9.3 of each lease agreement also indicates that interest on delinquent rent amounts shall accrue the day after the payment is late at 1% a month and the lessee shall also pay a late fee equal to 10% of the quarterly amount past due.

As required by the Enabling Act and the Constitution of New Mexico, the SLO has a fiduciary duty to state trust land. In general, lease revenue should benefit the trust beneficiaries, and penalties imposed upon a lessee for noncompliance with required lease payments protect the trust. The Commissioner's paramount duty, as trustee of state trust lands, is to manage the trust in the best interest of the trust beneficiaries, not the lessee.

Cause

The SLO General Counsel explained that the Commissioner suspended collection of rent payments due to the issuance of an unfavorable Attorney General's Opinion, Attorney

General's Opinion No. 08-02. The opinion concluded that BL-1775 contained certain provisions not authorized by New Mexico law. Due to this unfavorable opinion, the SLO's General Counsel indicated that it would not be "fair" to require this particular lessee to pay any more rent payments or charge the lessee any penalties or interest. It is unclear why the leases have not been relinquished.

Effect

The Commissioner's failure to collect rent payments, interest and penalties for the two leases has caused a financial loss to the trust beneficiaries in the amount of $335,975. The SLO violated its own lease provisions by allowing the lessee to be delinquent without recourse. The Commissioner, in this instance, is not managing trust assets in the best interest of the beneficiaries.

Recommendation

There appears to be no reasonable basis for the Commissioner's decision not to collect rent payments, interest and penalties under BL-1775 and BL-1776. First, Attorney General's Opinion 08-02 only pertains to BL-1775 and expressed "no opinion about the lease's enforceability." The Opinion went on to state the following: "It is within the province of the courts to decide issues of public policy that bear on the validity of contractual obligations. Consequently, we believe that whether the Solo lease is enforceable or not enforceable is a question of law for the courts to determine."

Second, the Commissioner has continued the practice of disbursing other IVCs and collecting rent payments under other planning and development leases that are similar to BL-1775 and BL-1776, despite Attorney General's Opinion 08-02 that found compensation for intangible improvements were inconsistent with current law. It is highly questionable why the Commissioner would engage in the inconsistent application of the Opinion's provisions to only BL-1775 and BL-1776 and not all planning and development leases that contain IVCs.

By allowing a lessee to forgo rent payments without a reasonable basis the Commissioner has not exercised his paramount duty to the trust. All lease payments should be collected timely and in accordance with the contractual lease agreement entered into by both parties. If payment cannot be collected, interest and late fees should be assessed or the lease should be relinquished in the best interest of the trust.

Finding 10 – Acceptance of Deficient Appraisals, Use of Rejected Appraisals and Failure to Conduct In-House Appraisal Reviews

Condition

During our test work, we noted certain instances in which the SLO in-house appraiser found an appraisal contained significant deficiencies, but the in-house appraiser nevertheless accepted the appraisal as adequate. We also noted certain instances where the SLO in-house review rejected the appraisal, but the SLO nonetheless used the appraisal. Finally, we also noted certain instances in which the SLO did not conduct in-house appraisal reviews.

Deficient Appraisals Accepted by SLO Staff

In one land exchange, the SLO's in-house appraiser's review report regarding an external certified appraiser's appraisal noted that the external appraiser's analysis is unacceptable and the methodology is inappropriate. The appraisal related to an exchange of 760 acres of trust land for 760 acres of private land, both valued at $114,000. The in-house reviewer explained, "[t]he subject appraisal does not conform to the Uniform Standards of Professional Appraisal Practice (USPAP) and fails to meet the requirements of the New Mexico State Land Office." Additionally, the in-house appraiser's review indicated that "[t]he valuation analysis is confusing and so limited in its presentation that it cannot be understood or evaluated as to its suitability." The review also states the following: "The data used for estimating values of the subject properties is unacceptable, and the appraiser's methods used for analyzing the data are inappropriate. Moreover, based on the sales data provided by the appraiser and other recent Land Office appraisals in the area, the appraiser's value estimates appear to fall on the extreme lower end of the range for properties of this type." Finally, the in-house appraiser's review stated, "[t]he appraisal report under review does not comply with applicable regulations and standards, and is incomplete, and the appraiser's conclusions [sic] the subject properties are not adequately supported." Yet, after this explicit rejection of the appraisal, the in-house reviewer nonetheless indicated that "given the lands to be exchanged are the same size, the overall effect on these low values are significantly minimized and may be considered reasonable in this context," and that "the appraiser's estimate may be considered reasonable for the sole purpose of this exchange."

Similarly, we noted an exchange in which the SLO in-house reviewer noted the appraisal was not adequate. The appraisal valued 733 acres of trust land at $165,000. The land to be received in the exchange was 41 acres of private land, valued at $144,000. Yet, after the reviewer indicated that the appraisal was "mostly subjective," that the development of the appraisal distracted from the overall reliability, and that editing oversights diminished the credibility of the analysis, the in-house reviewer stated the following: "Nonetheless, conversations with peers confirmed that there is a lack of sufficient data and affirm that the value conclusions are reasonable and within an accepted value range."

We also noted an in-house appraisal review related to a planning and development lease in which the in-house reviewer stated, "the report is found to be unacceptable" and "it appears that the appraiser's conclusion of value is reasonable for the subject." However,

the appraisal was still accepted by the SLO and we did not observe any documentation that would justify why an appraisal deemed unacceptable by the SLO could still be considered reasonable. The lease is for 640 acres of land valued at $3,840,000.

Rejected Appraisals Subsequently Used by SLO

Two in-house reviews rejected appraisals related to planning and development leases, but the SLO nonetheless used the appraisals to calculate the improvement value credit (IVC) due to the private developer. The reviews clearly indicated that the SLO in-house reviewer found the appraisals to be "unacceptable" and that the data used by the appraiser for analyzing the property was inadequate, unsupported and inappropriate. The reviews stated that "the appraisal report under review did not comply with applicable regulations and standards and should not be used for any transactions involving the State Land Office." However, the rejected appraisals were nonetheless used to determine the base appraised value of the land under the lease. The base appraised value is the base value amount used to calculate the developer's IVC. If the appraisal undervalues the land, the developer will receive a greater amount in the event of a sale. It does not appear the recommendations were considered or that an additional appraisal was performed for either transaction, as recommended by the SLO's in-house reviewer. One lease involves 2,449 acres of land valued at $15,900,000. The other lease involves 960 acres of trust land valued at $3,120,000.

We also noted a third in-house appraisal review that noted the appraisal was "rejected for use by the Land Commissioner" since the "analysis does not sufficiently convey and report the prevalent changes in market conditions" (See Finding 03 for detail regarding land sale 5941 which directly relates to this planning and development lease). Nevertheless, the Commissioner subsequently used the rejected appraisal to determine the base appraised value of the land under the lease. The lease involved 439 acres of land. Similar to the two aforementioned in-house appraisal reviews, it does not appear the recommendations were considered or that an additional appraisal was performed for either transaction, as recommended by the SLO's in-house reviewer.

In-House Appraisal Review Not Conducted

In one land exchange (167 acres of state trust land in exchange for 147 acres of private land, valued at 69,000 and 59,508, respectively) sampled the SLO did not conduct an in-house appraisal review of an appraisal performed by an external appraiser on private land that was proposed for exchange with trust land. Therefore, the SLO accepted the appraisal and completed the exchange without any kind of documented internal review of the private land's value.

In three planning and development leases sampled the SLO did not conduct in-house appraisal reviews of appraisals used to determine the IVC due to private developers. The three leases involved 1) 628 acres of state trust land valued at $250,000; 2) 559 acres of state trust land valued at $3,075,000; and 3) 147 acres of state trust land valued at $10,690,000. It is unclear why an in-house review was not performed on the three leases. In-house reviews of appraisals related to planning and development leases are especially critical given that the IVC is based on the appraised values of the land at the beginning and end of the lease. If the appraisals are inadequate, the developer may receive more

value for the land than it is actually worth. Without a review, it is not possible to determine whether the IVC calculation and the return due to the developer are accurate and reasonable.

Criteria

As required by the Enabling Act and the Constitution of New Mexico, the Commissioner has a fiduciary duty to state trust land beneficiaries. Section 10 of the Enabling Act requires that that trust lands be "appraised" and disposed of "at their true value." In general, planning and development leases require that the IVC be determined by a series of appraisals of the trust land performed near the beginning and end of the lease term. With regard to land exchanges, Rule 19.2.21.8(C) NMAC requires the trust "must receive at least true value for the trust lands that are conveyed to an exchange party" and that the Commissioner must "appraise the trust lands and the non-trust lands proposed to be exchanged at their true value." The SLO should establish proper internal controls over all classes of transactions (sales, exchanges, planning and development leases, etc.) to ensure the trust receives full compensation for trust lands disposed and that the outcome of such transactions best serve the beneficiaries. As part of its internal control process, the SLO's in-house appraiser reviews appraisals of the state trust land for reasonableness, accuracy and compliance with professional appraisal standards (USPAP), and submits his or her findings and recommendations in a review report to the Commissioner. Established controls, such as in-house appraisal reviews, should not be overridden without justifiable supporting cause.

Cause

The cause of the use of rejected appraisals appears to be override by the Commissioner as he is the form of final approval of the transaction in each instance. Those transactions enacted without an appraisal review and the deficient appraisals used by appraisers appear to be the cause of improper or lacking internal controls. Overall, the Commissioner is not correctly exercising his fiduciary duty to the trust in these instances.

Effect

The beneficiaries of the trust are not being best served. Inappropriately undervalued or overvalued appraisals may have resulted in a loss of trust revenue and violations of the Enabling Act.

Acceptable and appropriate appraisals are crucial to determining whether IVC calculations are proper. Through the use and disbursement of IVCs, the Commissioner pays private developers a percentage of the appraised value of the trust lands that are sold rather than depositing the total proceeds from these types of land sales into the land grant permanent fund. Therefore, when the Commissioner sells trust land developed under a planning and development lease and pays the developer a certain percentage of those sales proceeds, the trust may not receive the "true value" for the land sold if the Commissioner failed to use an acceptable and appropriate appraisal to determine the true value of the land. The use of deficient appraisals, rejected appraisals, or the failure to

conduct appraisals increases the risk that developers will be overpaid and the trust will not receive full and fair compensation for the "true value" of the trust lands sold.

Recommendation

The Commissioner has a fiduciary responsibility to the beneficiaries of state trust land and should take the greatest of care when determining whether or not certain transactions are in the best interest of the trust. The Commissioner should strictly adhere to the Enabling Act's requirements that trust lands be "appraised" and disposed of "at their true value." Additionally, it is imperative that non-compliance with SLO and USPAP requirements be taken very seriously when contemplating any transactions. Also, the SLO should ensure that an in-house review is conducted on all appraisals performed by an external appraiser to ensure the appraisal was acceptable and appropriate.

Per SLO records, from November 2006 through July 2010, payments by the Commissioner to developers as a result of IVCs were $15,495,148 of the total proceeds of $25,063,637 from land sales related to planning and development leases. In other words, from November 2006 through July 2010, developers received approximately 62% of the total proceeds from sales of trust lands developed under planning and development leases. Therefore, the Commissioner should always use acceptable appraisals to determine the IVC split amount, particularly when such a high percentage of sales proceeds are paid to the private developers and not the trust beneficiaries.

Differences of opinion and subjectivity may exist in relation to certain transactions; however, the SLO should create and maintain documentation to support how those potential issues with any transaction were overcome in the best interest of the trust. For every potential land exchange, sale and planning and development lease, we recommend that the SLO document and retain such documentation regarding how the in-house appraisal reviews were resolved or responded to in the case of disagreement with the transaction. In addition, proper support should be maintained when the SLO in-house appraiser identifies deficiencies in external appraisals and those appraisals are still utilized in the transaction.

Finding 11 – Failure to Consider Field Reviews

Condition

We noted instances where the Commissioner consummated certain exchanges of trust land despite recommendations against the exchanges by the SLO's field reviewers and the SLO's Oil, Gas and Mineral Division (OGMD).

In one instance, an SLO District Resource Manager stationed in the location of a proposed exchange rejected the exchange; however, the SLO subsequently carried out the exchange. The Manager stated that the proposed exchange would create a split estate and cause a negative impact on the SLO's oil and gas leases. Furthermore, the Manager noted that the trust would lose money if the proposed land exchange takes place, and also stated that the exchange would not serve the best interests of the trust. The field review stated that "the proposed land exchange does not result in a Substantial Benefit to the Trust, which is a main provision in land exchange [sic]." The review states that the exchange would not serve the best interest of the trust, and would result in "a monetary negative impact to the Trust should the exchange take place." The review also indicated that the "Trust will also lose managerial rights over 920 acres of surface rights where State Trust minerals are present." Despite these adverse recommendations, the Commissioner still carried out the exchanges. We did not observe any documentation sufficient to address the concerns and recommendations made in the field review. We also did not observe any sufficient documentation justifying why the Commissioner decided the transaction was in the best interest of the trust in light of the concerns and recommendations made in the field review.

We also noted an additional exchange in which the SLO field reviewers considered the trust land "prime land" in comparison to the private land offered for exchange and recommended against consummating the exchanges. One field reviewer stated the trust land should not be exchanged "due to the healthy forest conditions and abundant wildlife." Another reviewer stated that if the SLO moves forward with the exchange, the "trust will lose valuable hunting and forestland." That reviewer recommended the "SLO proceed with a more detailed analysis of the exchange, focusing on alternatives to the proposed state section." Again, we did not observe any documentation sufficient to address the concerns and recommendations made in the field reviews. We also did not observe any sufficient documentation justifying why the Commissioner decided the transaction was in the best interest of the trust in light of the concerns and recommendations made in the field reviews.

Finally, we reviewed three other exchanges in which the SLO's field reviewers and the OGMD raised concerns about the exchanges, and in three instances recommended against the exchanges. For example, in one field review a SLO District Resource Manager recommended against a proposed exchange because access to the state trust land "is superior to the offered land;" the state trust land is "more valuable than the offered land;" the "proposed exchange would reduce hunter access to the State Land;" and the exchange would create a split estate. The District Resource Manager concluded that the proposed exchange is not in the best interest of the trust beneficiaries. Another review from the

OGMD recommended against a proposed exchange because the exchange would create a split estate and accessing the land in the future for mineral exploration and extraction "will be far more difficult." The review concluded that the "exchange does not appear to be in the 'Best Interest of the Trust' from a mineral standpoint." Another review from the OGMD stated that a proposed land exchange would "result in a 'Split Estate' complicating any future mining development . . . as quarry operations require extensive use of the site surface." However, the Commissioner nevertheless consummated the exchanges and it does not appear that these concerns or recommendations were considered. We did not observe any documentation sufficient to address the concerns and recommendations made in the field reviews. We also did not observe any sufficient documentation justifying why the Commissioner decided the transaction was in the best interest of the trust in light of the concerns and recommendations made in the field reviews.

Criteria

As required by the Enabling Act and the Constitution of New Mexico, the SLO has a fiduciary duty to state trust land beneficiaries. The SLO should establish proper internal controls over all classes of transactions (sales, exchanges, planning and development leases, etc.) to ensure the outcome of such transactions best serve the beneficiaries.

Cause

The cause appears to be override by the Commissioner as he grants final approval of the transaction in each instance.

Effect

The beneficiaries of the trust are not being best served because it is questionable whether land exchanges approved by the Commissioner are in the best interest of the trust. Exchanges of state trust land are not transparent to the beneficiaries or the public without supporting documentation to justify why the Commissioner overrode recommendations by SLO staff that the transactions were not in the best interest of the trust.

Recommendation

The Commissioner has a fiduciary responsibility to the beneficiaries of the trust land. The Commissioner should take the greatest of care when concluding on whether or not certain transactions are in the best interest of the trust. Differences of opinion and subjectivity may exist in relation to certain transactions; however, the SLO should create and maintain documentation to support how those potential issues with any transaction were overcome in the best interest of the trust.

For every potential land exchange, sale and planning and development lease, we recommend that the SLO document and retain such documentation regarding how adverse recommendations by SLO staff were resolved or responded to in the case of disagreement with the transaction.

Finding 12 – Failure to Notify Beneficiaries of Applications to Purchase State Trust Land

Condition

For all land sales we reviewed, the SLO failed to notify beneficiary institutions of applications to purchase state trust land as required by law. There was no documentation in the file folders for selected sales items that supported the SLO advising the beneficiaries of the receipt of the application. The SLO only notified beneficiary institutions after the sales transactions were completed.

Criteria

Rule 19.2.14.8(A) NMAC provides, "[t]he beneficiary institution shall be advised of the receipt of any application to purchase." Notification to the beneficiary should be prompt in order to carry out the provisions of this rule.

Cause

The SLO has not complied with its own rules it developed for notifying beneficiaries of potential sales of trust lands.

Effect

The beneficiaries of state trust lands are uninformed prior to the closing of a land sale. Without prior notice, the beneficiaries are informed only after the sale is completed. Therefore, the beneficiaries are not provided an opportunity to communicate to the Commissioner any concerns they may have about a land sale before the transaction is finalized. The SLO's failure to promptly notify beneficiaries forecloses their participation in the process and it is not transparent to those who are required to benefit from the trust.

Recommendation

The SLO should strictly adhere to the requirements of Rule 19.2.14.8(A) NMAC. Beneficiaries should be informed in a timely manner of applications to purchase state trust land. Compliance will ensure protection of the trust and create greater transparency in the potential sale of state trust lands.

Finding 13 – Appraisals Not on Income Basis for Land Exchanges in the White's Peak Area

Condition

All of the appraisal reports scrutinized during the course of this special examination have been based on the sales comparison approach. None were based on either the income or the cost approach. The sales comparison basis is generally appropriate for vacant land that has no improvements and is generally not the source of any significant revenue. This basis of valuation depends on identifying comparable properties that are located nearby that have sold recently.

At least three of the four land owners involved with land exchanges in the White's Peak area allow hunters to hunt elk and other game on their lands for a price. Even though this is public knowledge and much information about hunting on the lands is available on the internet, the SLO appears to ignore the possibility that revenues can be derived from vacant land with no improvements.

All of the appraisals of land involved in the exchange with David Stanley were based solely on the sales comparison approach. None gave any consideration to the amount of revenue that could be derived from the land.

For example, in the exchange with David Stanley, the SLO could have used the information about the potential income earning capacity of the lands exchanged to David Stanley as a bargaining chip to obtain a better ratio of acres received versus acres given. In the Stanley exchange, SLO received 3,327 acres of non-trust land for 7,206 acres of trust land for a net loss of 3,879 acres of state trust land.

According to records at the New Mexico Department of Game and Fish, the "Elk Occupied Acreage" in Game Management Unit 48 (GMU 48), also known as the White's Peak area, owned by David Stanley rose from 14,952 acres in the 2009-2010 hunting season to 22,087 acres in the 2010-2011 hunting season. The increase of 7,135 acres was entirely attributable to the exchange of lands between Mr. Stanley and the SLO. As a result of Mr. Stanley's increased acreage in GMU 48, the number of permits for hunting mature bull elk allocated to David Stanley rose from 50 to 70.

The right to hunt a mature bull elk on privately owned lands can cost as much as $12,000 per hunt. This is evidenced by the information on the website for UU Bar Ranch, which is adjacent to Mr. Stanley's lands in the White's Peak area. If each of Mr. Stanley's seventy mature bull elk permits allocations brought in $12,000 of revenue, there would be gross income of $840,000 over the hunting season. This factor alone calls for the lands in exchange with David Stanley to be based on the income approach rather than the sales comparison approach.

Criteria

Standards Rule 1-4 of the Uniform Standards of Professional Appraisal Practice (USPAP) provides that in developing a real property appraisal, an appraiser must collect, verify, and analyze all information necessary for credible assignment results.

The SLO has adopted the USPAP as the appraisal standards to be followed. The USPAP establish the requirements for the development and reporting of real property appraisals. Standard 1 of USPAP includes Standards Rule 1-4 which requires the appraiser to collect, verify, and analyze all information necessary for credible assignment results.

Section 10 of the Enabling Act requires that that trust lands be "appraised" and disposed of "at their true value." In addition, all values of land to be exchanged, whether trust land or private land, should be determined in accordance with SLO rules. Rule 19.2.21.8(C) NMAC provides that "[i]n any exchange, the trust must receive at least true value for the trust lands that are conveyed to an exchange party."

Cause

The cost and income approaches appear to be avoided by appraisers who perform work for transactions pertaining to state trust land. Undoubtedly, both of these approaches involve having to obtain more information about the specific property being appraised. For example, the income approach would necessarily involve having to determine the gross income potential of the property with some degree of accuracy. This type of information is not as easy to obtain as data on comparable sales of vacant land.

Effect

The beneficiaries of state trust land may be deprived of receiving at least true value for the trust lands that are conveyed to an exchange party. Also, in the future, Mr. Stanley will derive more revenue from elk hunting on his land because of the increase in the number of elk hunting permits allocated to him.

Recommendation

We believe the Commissioner should have the lands in the White's Peak area appraised with consideration of the amount of revenue that will be derived in the future. This may make the appraisals more complicated, but it would then recognize the income earned by the private land owners in the area from hunting on their lands.

The appraisers, if they are to implement this approach to the appraisal of lands on which the land owner derives fees for hunting privileges, will have to have financial information not normally readily available. The SLO, because it is a New Mexico state government agency, could enter into joint powers agreements with other state agencies and departments whereby it would be able to obtain information that would make it possible to develop a meaningful financial analysis of lands, such as those located in the White's Peak area where the landowners are obviously deriving income from allowing hunting on their lands. Without a meaningful financial analysis of the revenue producing aspects of

the land, the income approach to appraising lands will be difficult, if not impossible, to implement. See Finding 14 on the Lack of Financial Analyses on Land Transactions.

Finding 14 – Lack of Financial Analyses on Land Transactions

Condition

Overall, the sales and planning and development leases tested during our examination lacked financial analyses that comprehensively captured all the significant and pertinent aspects of the transactions. Nearly all of the exchange transactions we reviewed omitted financial analyses that comprehensively captured all the significant and pertinent aspects of the transactions. In certain instances where financial analyses were performed for exchanges, we noted the SLO failed to update the analysis to reflect the final acreage in the transaction. Additionally, all planning and development leases tested that contain improvement value credits lacked financial analyses that would justify the IVC percentage paid to the developer.

Criteria

As required by the Enabling Act and the Constitution of New Mexico, the Commissioner has a fiduciary duty to state trust land beneficiaries. The Commissioner should establish proper internal controls over all classes of land transactions (sales, exchanges, planning and development leases, etc.) to ensure the outcome of such transactions best serve the beneficiaries. Established controls, such as financial analyses, should be performed for every potential transaction.

Cause

Lack of or improper internal controls related to land transactions.

Effect

The beneficiaries of the trust are not being best served. The lack of financial analysis very likely has resulted in a loss of trust revenue.

Recommendation

The Commissioner has a fiduciary responsibility to the beneficiaries of state trust land. The Commissioner and SLO staff should exact great care when determining whether or not certain transactions are in the best interest of the trust. A financial analysis should be performed on all proposed exchanges, sales and planning and development business leases in a consistent manner to ensure all financial aspects of land transactions are captured.

SLO staff may need to perform financial analyses more than once or update the analysis depending on the transaction. For instance, if the end result of a sale varies from what was originally expected and originally communicated (i.e., to beneficiaries), an analysis should be updated and considered during subsequent transactions. The calculations and other elements of the analysis should be reasonable and pertinent to the transaction. Moreover, it should be apparent that the Commissioner considered the analysis prior to approving the transaction. Performing a financial analysis on all transactions will help

identify those transactions which are in the best interest of the trust and those that are not in the best interest.

Furthermore, the SLO should prepare a financial analysis of proposed land exchanges that considers the revenue producing potential of the state trust lands to be exchanged. For example, the SLO could develop a meaningful financial analysis of the proposed exchanges which would consider the potential earnings capacity of the property to estimate the gross income potential of the property. The income approach to appraising land depends upon the availability of financial information that might not normally be accessible to the appraisers. The financial analysis would have to be prepared before the appraisal. The appraisers would begin their appraisal process by first reviewing the SLO financial analysis.

Finding 15 – Lack of Formal Policies and Procedures for Improvement Value Credits

Condition

The SLO has no formal policies or procedures that are used to determine the improvement value credit (IVC) "split" between the Commissioner and private developers under planning and development leases. During our test work of business leases, we noted all planning and development lease contracts require the Commissioner to pay an IVC to the private developer upon the subsequent sale, lease or exchange of the land. In general, lessees who enter into planning and development leases with the Commissioner are entitled to IVCs in return for preparing master plans for development of the trust land and for obtaining from government agencies certain legal rights related to the land. The IVC "split," or the IVC percentage to which the lessee is entitled and the IVC percentage which is retained by the trust, is determined at the discretion of the Commissioner and is negotiated prior to execution of the lease. The IVC split ratios between the Commissioner and the developers vary significantly between each lease.

Per SLO records, from November 2006 through July 2010, payments by the Commissioner to developers as a result of IVCs were $15,495,148 of the total proceeds of $25,063,637 from land sales related to planning and development leases. In other words, from November 2006 through July 2010, developers received approximately 62% of the total proceeds from sales of trust lands developed under planning and development leases. One planning and development lease awarded under the former Commissioner included a developer IVC split as high as 86% for a total of $8,457,055, given that the total sales amount of the land was $10,130,000. We also noted other leases contained IVCs that varied by the following percentages to developers: 40%, 50%, and 66.67%.

There is no documentation within the planning and development lease contracts containing IVCs which indicates how the Commissioner determined the IVC split. The current Assistant Commissioner of Special Projects (former Assistant Commissioner of the Commercial Division) confirmed in an interview with the OSA that the SLO has no formal policies or procedures to determine the IVC split between the Commissioner and each developer. The SLO has no documentation that reveals what reasonable considerations or factors SLO staff and the Commissioner use to determine the percentage split. Moreover, the IVC splits are negotiated prior to the execution of planning and development leases – before any improvements are made to the trust land.

Criteria

As required by the Enabling Act and the Constitution of New Mexico, the Commissioner has a fiduciary duty to state trust land beneficiaries. Section 10 of the Enabling Act requires that that trust lands be "appraised" and disposed of "at their true value." The SLO should establish proper internal controls to determine the IVC split in planning and development leases to ensure the outcome of such transactions best serve the trust beneficiaries.

Cause

Lack of or improper internal controls related to land transactions.

Effect

Lack of policies and procedures to determine the IVC split in planning and development leases increases the risk that the Enabling Act may be violated. The Commissioner pays private developers a percentage of the appraised value of the trust lands that are sold rather than depositing the total proceeds from these types of land sales into the land grant permanent fund. Therefore, when the Commissioner sells trust land developed under a planning and development lease and pays the developer a certain percentage of those sales proceeds, the trust may not receive the "true value" for the land sold if the IVC split overpays the developer for the improvements made. No safeguards exist to prevent overpayments to developers and to ensure that the trust receives full and fair compensation for the "true value" of the trust lands sold upon termination of the leases. Additionally, there is no transparency in the process due to the SLO's failure to maintain supporting documentation regarding the IVC split determination. As a result, there is a risk that the trust did not receive full compensation for over $25 million in trust lands sold from November 2006 through July 2010, potentially resulting in multiple violations of the Enabling Act.

Recommendation

The Commissioner has a fiduciary responsibility to the beneficiaries of state trust land and should take the greatest of care when determining whether or not certain transactions are in the best interest of the trust. The Commissioner's lack of formal policies and procedures related to determining a private developer's IVC split augments the risk that trust revenue may be lost and the Enabling Act may be violated. The SLO should implement formal policies and procedures to determine the IVC split amount, particularly when such a high percentage of sales proceeds are paid to the private developers and not the trust beneficiaries. Such procedures should be consistently and fairly applied to all planning and development leases, and they should ensure that that IVC split determinations are made in the best interest of the trust and not the developers. The SLO should maintain supporting documentation for all IVC split determinations.

Risk Observation 01 – Notice to Beneficiary Institutions

Summary

During our test work of land exchanges and land sales, we noted that the SLO sent untimely notice to beneficiaries. We reviewed six notices (related to one exchange) the SLO sent almost three years after the transaction was finalized, and the SLO sent another six notices (related to one sale) close to one year after the sale was completed.

There also was no indication in any of the exchange files we tested that the Commissioner provided a copy of each exchange request to the beneficiaries of the proposed exchange prior to the closing of the transaction. Rule 19.2.21.13(A) NMAC grants the Commissioner the option to provide the beneficiaries an opportunity to review the proposed exchange before it is transacted. Without prior notice, the beneficiaries are informed only after the exchange is completed. Therefore, the beneficiaries are not provided an opportunity to communicate to the Commissioner any concerns they may have about an exchange before the transaction is finalized.

Recommendation

Beneficiary notices should be sent timely following the completion of a land exchange or sale to ensure transparency in the exchange or sale. The SLO should also amend the elements already included in the notice to beneficiaries. The elements should include the amount of relinquished lease revenue related to the exchange or sale so that the beneficiary may have an accurate and complete depiction of the transaction. The elements should be consistent, complete and accurate in every beneficiary notice to ensure proper transparency of each and every land exchange and sale. We also recommend that beneficiary notices be required when the Commissioner receives exchange requests.

Risk Observation 02 – Trust lands Not Included in SLO Audit Report

Summary

During our examination, we discovered that the millions of acres of land surface rights and mineral rights managed by the Commissioner in his role as a trustee are not included in the SLO financial statements and are thus not included in the SLO's annual financial audit.

The Government Accounting Standards Board (GASB) is the entity empowered to establish financial accounting standards for governments. Under GASB Statement 34 (GASB 34), issued in 1999, the trust established by the New Mexico Enabling Act, for which the Commissioner is the trustee, as is an investment trust fund. The land and mineral rights owned by the trust are the assets in which the trust has its net worth invested. In accordance with GASB 34, the trust should be reported as a trust in the fiduciary fund portion of the SLO audit report. The land has never been included in the financial audit of the SLO.

GASB is currently conducting a research project in conjunction with the Western States Land Commissioners Association. GASB has named it the "Fair Value Measurement Project." GASB reports that some Western states report state land trusts. The GASB project's staff research indicates that these assets are reported inconsistently from state to state because there is a lack of accounting and reporting guidance.

Recommendation

In the future, the SLO and the Office of the State Auditor should work together with the external auditors who audit SLO's financial statements to develop an approach to audit these trust assets and report them in a meaningful way in the SLO annual audit report.

Risk Observation 03 – Failure to Adhere to Publicized Bid Process

Summary

We noted the SLO published a request for proposals (RFP) for the lease of state trust lands in Las Cruces, but the Commissioner awarded the lease prior to the specified deadline for submission of the proposals. In fact, the Commissioner awarded the lease prior to the publication of the final advertisement seeking proposals. Although the lease appears to have been a "non-bid lease," there was no documentation in the lease file relating to the RFP, explaining why the Commissioner publicly sought proposals for the lease, or justifying why the Commissioner failed to comply with the competitive bid process described by the RFP.

On December 22, 25 and 27, 2006, the SLO published a "Notice of Request for Proposals" in the *Las Cruces Sun-News* seeking "proposals for business leases for real estate planning and development . . . for state trust lands within the Las Cruces Extra-Territorial Zone." The notice stated that proposals "should be submitted by 4:00 p.m. on February 1, 2007 to the State Land Office." The notice also stated that the proposal should contain the following information:

- a description of how the lessee proposes to develop the land, including a conceptual schematic plan, and a development timeline;
- a plan for obtaining governmental approvals of the land use plan ;
- the proposed consideration the lessee will pay for the lease;
- the proposed portion of the improvement value credit attributable to the proposed development that the Commissioner will receive; and
- information showing the bidder's professional experience and financial ability to perform.

The Commissioner awarded and signed the planning and development lease, BL-1775, on December 26, 2006, only four days after the notice was first published in the *Las Cruces Sun-News*. The lease executed by the SLO did not include all the state trust lands proposed for lease within the Las Cruces Extra-Territorial Zone.

Upon review of BL-1775, the Enabling Act and SLO rules, it appears that the Commissioner was not required to award the lease pursuant to a competitive bid process because it was considered a "non-bid lease" in 2006. Section 8 of BL-1775 limited the term of the lease to five years. The lease file did not contain documentation relating to the RFP, explaining why the Commissioner publicly sought proposals for the lease, or justifying why the Commissioner failed to comply with the competitive bid process described by the RFP.

Recommendation

The Commissioner's initial treatment of the lease as one subject to the competitive bid process, and his subsequent award of the lease prior to the final advertisement and

established deadline for receipt of proposals, diminishes the perception that the Commissioner may have awarded the lease in the best interest of the trust. Although the Commissioner possessed the legal discretion to award the lease, we recommend that the Commissioner adhere to publicized bid processes to ensure public confidence in the management of state trust lands.

Additionally, documentation provided by the SLO asserts that the Commissioner's choice to execute BL-1775 was the result of months of negotiations with experienced developers that preceded publication of the RFP. The documentation further states that the decision to award the lease did not foreclose the opportunity for other developers to enter similar leases with the Commissioner for other portions of the state trust land within the Las Cruces Extra-Territorial Zone. However, the SLO did not maintain this documentation or any other documentation related to the RFP with the lease file. We recommend that the lease file contain all relevant documentation related to the transaction to ensure transparency in the Commissioner's management of state trust lands.

Risk Observation 04 – Code of Conduct and Conflicts of Interest

Summary

The Governmental Conduct Act (GCA), Chapter 10, Article 16 NMSA 1978, sets forth certain ethics requirements for state officers and employees. Section 10-16-11(A) NMSA 1978 of the GCA provides that "each elected statewide executive branch public officer shall adopt a general code of conduct for employees subject to his control." Additionally, Section 10-16-11(D) NMSA 1978 provides that "[c]odes of conduct shall be reviewed at least once every four years." The Commissioner should have adopted and filed with the Secretary of State a code of conduct for employees subject to his control as soon as practicable after he assumed his office on January 1, 2003. The SLO code of conduct likewise should have been reviewed and, if deemed necessary, revised in early 2007.

As a result of an inquiry by the OSA in connection with this special examination, the SLO subsequently prepared and filed a code of conduct with the Secretary of State on May 22, 2009, which was more than six years past the required due date.

Chapter 10, Article 16, Section 3 NMSA 1978 of the GCA provides, in part, that public officers such as the Commissioner and each state employee "shall treat his government position as a public trust. He shall use the powers and resources of public office only to advance the public interest and not to obtain personal benefits or pursue private interests incompatible with the public interest." Further, the GCA provides that "[f]ull disclosure of real or potential conflicts of interest shall be a guiding principle for determining appropriate conduct."

The OSA requested copies of all the conflict of interest forms that were completed by SLO employees and submitted to management for review. Seven conflict of interest forms were received by SLO management. The OSA then requested SLO's response to the employees' conflict of interest notifications. The SLO was unable to provide any documentation or correspondence showing the action taken by management to address the potential conflicts of interest reported on the forms by the seven employees.

Recommendation

Strong internal control activities will help the Commissioner and management prevent, deter and detect potential fraud, waste, and abuse as they relate to the management state trust lands. Therefore, the Commissioner and SLO management should ensure timely filing and review of a code of conduct applicable to SLO employees. Additionally, the Commissioner and SLO management should develop and implement written policies and procedures to address reported or unreported conflicts of interest by SLO employees and the Commissioner, and maintain adequate documentation to substantiate the corrective action taken by the SLO. All SLO employees and the Commissioner should be required to fill out a conflict of interest form on their first day of employment and at least annually thereafter.

Risk Observation 05 – Lack of Campaign Contribution Disclosure and Prohibition Requirements Applicable to State Trust Land Transactions

Summary

State law does not currently provide for campaign contribution disclosure requirements that specifically apply to trust land transactions, or prohibit contributions during the Commissioner's application or negotiation process for the exchange, sale or lease of state trust lands. During our test work of land exchanges, land sales and planning and development leases, we noted a large number of certain sampled items in which the applicant, who was subsequently awarded the exchange, sale or lease, made campaign contributions to the Commissioner in close temporal proximity to the awards. In certain cases, we noted that an exchange party or a purchaser of trust land made significant contributions that occurred near the date of application or closing of the agreement.

This report does not assert that the Commissioner entered into these land transactions in exchange for campaign contributions. Neither does this report assert that any person received favorable treatment from or access to the Commissioner as a result of the campaign contributions. However, given that trust land transactions can be in the hundreds of millions of dollars with noticeable monetary benefits to private developers, and the broad discretion with which the Commissioner may manage these transactions, we believe it is prudent and in the best interest of the trust and the public that disclosure requirements be considered.

Recommendation

New Mexico law, specifically Section 13-1-191.1 NMSA 1978, currently provides certain disclosure and prohibition requirements for campaign contributions to public officials who have the authority to award or influence the award of contracts related to the procurement of goods and services. We recommend that the New Mexico Legislature consider similar disclosure requirements for state trust land transactions. Should the New Mexico Legislature wish to consider more stringent requirements, Section 10-16-13.3 NMSA 1978 prohibits certain businesses that contract with the state from contributing anything of value to certain public officers or employees who have authority over the investment of public money or issuance of bonds, the revenue of which is used for public projects in the state. The Legislature could consider a similar model for state trust land transactions.

V. EXIT CONFERENCE

An exit conference to discuss the contents of the report was held at the New Mexico State Land Office in Santa Fe, New Mexico on Wednesday, December 8, 2010 and attended by the following:

State Land Office Personnel:

Patrick Lyons, Commissioner of Public Lands
Dennis Garcia, Deputy Commissioner
Della Gutierrez, Assistant Commissioner, Deputy Director of ASD
Robert Stranahan, General Counsel
John Sullivan, Associate Counsel
Margaret Sena, Deputy Director of Accounting

Office of the State Auditor Personnel:

Hector Balderas, State Auditor
Carla Martinez, CPA, Deputy State Auditor
Evan Blackstone, General Counsel
John Earnshaw, CPA, Audit Manager
Natalie Cordova, Audit Supervisor