

**STATE OF NEW MEXICO  
NEW MEXICO STATE LAND OFFICE**



**COMMISSIONER'S RESPONSE TO  
FINDING 09**

**Patrick H. Lyons  
Commissioner of Public Lands  
December 17, 2010**

## **FINDING 09- Planning and Development Lease Payments Not Collected**

**Assertions-** Solo Investments L.L.C. and Katerina L.L.C. ceased payments on BL-1775 and BL-1776 respectively.

**Response-** The audit report largely ignores the reasons that the lessee stopped making payments and the reasons the land office did not seek to collect those payments. As OSA knows, Solo Investments L.L.C. stopped payments in response to Attorney General Opinion 08-02, which contends that state law did not provide specific authority for issuance of BL-1775. While land office believes that the Attorney General's opinion is flawed in many respects (*see* legal memorandum attached), most notably in its treatment of the land office as a regulatory agency, the opinion cast substantial doubt on the enforceability of the BL-1775 and all other similar leases. Katerina L.L.C. is owned and operated by the same person as Solo Investments L.L.C., and the terms of BL-1776 are identical to BL-1775. Litigation regarding a default under either lease could have produced a court decision casting doubt on all planning and development leases. In both instances, after the developer refused to make payments a discretionary decision was made in consultation with the land office's general counsel to forego enforcement of BL-1775 and BL-1776.

SLO informed OSA that litigation would be costly, would require extensive staff time, and was uncertain in terms of result, and that a discretionary decision was made to forego enforcement. Once again, the audit report's finding fails to consider the legal

landscape and the commissioner's discretion to make a decision that he reasonably believes to be in the overall best interests of the trust..

While none of the other lessee's defaulted in response to the Attorney General's opinion, that was a substantial possibility. Therefore, the Commissioner requested that the legislature enact enabling legislation, which was blocked by the very same partisan legislators who requested the Attorney General's opinion and your Special Audit. Having raised concerns about the legal authority for leases providing indisputable benefit to trust, OSA and the attorney general did nothing to assist in the legislative effort to address those concerns.

The audit report fails to note that the issuance of BL-1775 and BL-1776 produced \$116,437 in rental payments and \$578,364.97 worth of planning and development services for the state trust lands. When a effort to obtain an agreement on new leases failed, both leases were cancelled for non-payment, and the lessees will receive nothing in exchange for the benefits they produced for the trust. In the real world, receiving compensation and services at no cost to the land office should be considered a good business practice.

**STATE OF NEW MEXICO  
NEW MEXICO STATE LAND OFFICE**



**COMMISSIONER'S RESPONSE TO  
FINDING 10**

**Patrick H. Lyons  
Commissioner of Public Lands  
December 17, 2010**

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

As I explained to the Auditors, unlike a typical review appraiser, the primary function of the Chief Appraiser (reviewer) for the Land Office is to advise the Commissioner as to whether a transaction based on a given appraisal value estimate is beneficial to the Trust.

While the compliance and credibility of the appraisal report is important, the Land Office reviewer may rely on other information in making this determination when the appraisal report is deficient.

As I also explained, contracting for an appraisal is expensive and time-consuming. It is a waste of Land Office resources and not in the best interests of the Trust to get a second appraisal when it will most likely reflect the same value estimate as the first appraisal.

The following is my response to the examples presented with this finding. Please note, however, that since the Auditor only provided land areas and values, I often had to guess as to which transactions the examples applied.

### ***Deficient Appraisals Accepted by SLO Staff***

#### Goff Exchange (LE-0601):

The Auditor deliberately takes statements out of context from my review report in order to mislead the reader.

For example, the Auditor states;

“...the in-house review nonetheless indicated that ‘the appraiser’s estimates may be considered reasonable for the sole purpose of this exchange’.”

However, the Auditor does not include the paragraphs proceeding this, which read;

“...the appraiser’s value estimates appear to fall on the extreme lower end of the range for properties of this type.

However, given that the lands to be exchanged are the same size, the overall effect of these low values are significantly minimized and may be considered reasonable in this context.”

or the paragraph following this statement;

“However, I recommend that any additional consideration, as normally required of the applicant, be based on a higher than typical percentage to account for the low appraisal values.”

Scott McDowell  
December 13, 2010  
Response to State Auditor Findings

*By including this additional information, it is clear that my decision to accept the appraisal values is not arbitrary as the Auditor attempts to portray it, and as I recommended, the applicant did in fact pay an additional 26% (instead of the normal 20%) of the appraised value.*

Orozco Exchange (LE-0413):

This transaction occurred before I started with the Land Office. However, it is clearly stated in the review report that the reviewer had sufficient information from other sources to justify accepting the appraiser's value conclusion, despite deficiencies of the appraisal report.

There is no requirement that the Land Office reviewer provide in her report all of the data relied upon in rendering her opinion and recommendation to the Commissioner.

Cupid Business Lease (BL-1791):

Again, the Auditor attempts to paint a false picture by taking statements taken out of context from my review report.

In this case, the Auditor states;

“...the in-house review stated that ‘the report is found to be unacceptable’ and ‘it appears that the appraiser’s conclusion of value is reasonable for the subject’.”

However, the Auditor does not include the statements proceeding this;

“Although some of the sales information is acceptable, the appraiser's analysis of the data is not supported or credible.

However, the appraiser’s unit value estimate for the subject falls within the unadjusted unit value range of the relevant sales, and is consistent with recent, reviewed and approved appraisals of comparable Land Office properties in the area.”

or the sentence that follows;

“...and it is unlikely that a reviewer’s analysis would result in a meaningfully different conclusion.”

*The fact that the subject value estimate is consistent with conclusions from other recent, approved appraisals in the area more than justifies my action in this regard. If the Auditor's intentions were truly honorable, this example would not have been included in this finding.*

***Rejected Appraisals Subsequently Used by SLO***

It appears that the first two business leases cited are; (1) Vistas at Presidio (BL-1775) and (2) Jornada Road (BL-1776).

*Neither of the appraisals in question were used, or are intended to be used, to establish a base value for calculating IVC. Therefore, the Auditor's claim is completely false.*

An important fact not disclosed by the Auditor, is that the Land Office is nearly always entitled to a much larger percentage of the IVC on P&D Leases, so the higher the IVC, the more cash the Land Office receives, in addition to the increased value of the land and any lot bonuses.

*One glaring exception to this is the Mesa del Sol project, in which the applicant-developer received over 80% of the IVC. However, this transaction did not take place during the Lyons administration.*

***In-House Appraisal Review Not Conducted***

Given that the Auditor fails to specify the transactions which an in-house appraisal review did not occur, I am unable to rebuff or verify the Auditor's assumption.

In general, however, an "in-house" appraisal review does not necessarily need to be written or performed by the Chief Appraiser, and there are cases where one is not feasible or even possible. For instance, the Chief Appraiser position was vacant for several months prior to my arrival in mid February 2007, and time frames for various transactions in process during that period would not permit a delay until the position was filled.

Another important fact I discussed with the Auditors, but not mentioned in this finding, is that the appraisal review function for the New Mexico State Land Office is a *one-man operation* (the Arizona Land Office has a staff of 10 appraisers). As a result, there are instances when time does not permit the preparation of a written report for every review conducted. However, written reviews are always prepared where Land Office Rules require them.

**STATE OF NEW MEXICO  
NEW MEXICO STATE LAND OFFICE**



**COMMISSIONER'S RESPONSE TO  
FINDING 11**

**Patrick H. Lyons  
Commissioner of Public Lands  
December 17, 2010**



## Finding 11 –

### **“FAILURE TO CONSIDER FIELD REVIEWS” LE-0601 Goff Dairy**

SLO District Resource Managers do not reject exchanges. District Resource Managers (DRM's) **do not** have the authority to reject an exchange. Nor do they have the authority to accept an exchange. Only the Commissioner of Public Lands has the authority to do so. Furthermore, the statements, opinions, and/or recommendations contained in a DRM's field report are neither rejected nor accepted, and as such no documentation would be included in any file. Rather, the statements, opinions, and/or recommendations are taken into consideration when making the determination of whether the proposed agency action is in the best interest of the trust.

In this case, the DRM was tasked with answering a few basic questions about both the Trust Land and offered land. On February 26, 2007 Myra Meyers, DRM Hobbs District completed field report MHM-1069. That field report failed to address certain factual matters such as components of the physical description, the neighborhood description, any environmental issues, and any cultural resources for both the state lands and offered lands and instead the DRM focused on her opinions on the exchange. Furthermore, while that report did address the DRM's opinion of value, the DRM is not a certified appraiser. Two different licensed appraisers, Oscar E. Kunkel and Tyra Sandoval agreed on the appraised value of \$150.00 per acre as stated in both the original and updated summary appraisals.

On August, 7, 2008, DRM Myra Harrison completed field report MHH-1338. That field report contained no adverse statements against the exchange. The auditor focused on the subjective statements of the DRM from a field report that was supplemented later due to a significant change in the exchange proposal. The auditor failed to address whether or not the later field report and its lack of adverse comments against the exchange, considering the change in the exchange proposal was in any way taken into consideration in their finding. It is important to note that although, this exchange did split trust land surface and mineral estates, the DRM's position that the trust would lose money and that the exchange would not serve the best interests of the trust were speculative, and supported by values inconsistent with values accepted by the more qualified licensed appraisers, ignored other, more material benefits to the trust.

### **DRM COMMENTS OF SPLIT ESTATE:**

The Exchange Staff and the Commissioner of Public Lands did consider the statement by the District Resource Manager as well as the opinion of all other divisions who were contacted in the form of the ***Division Notification*** in Phase I, Due Diligence for the land exchange. The Oil, Gas and Mineral Division (OGMD) addressed the impact on the mineral estate. The DRM's opinion that the split estate would cause a negative effect on the oil and gas leases, was refuted through research by SLO staff. The DRM's opinion was discussed, but not given any consideration because the land was already leased for oil and gas activity and an active well was located on one of the aliquot parts. Documentation of the encumbrances were part of the research and located in the file with the Bid Packet. The following are the list of oil & gas leases on the state trust lands that were retained in the exchange. The auditor had access to this information as well as the Division Notification responses and chose not to consider them but to pick out the

subjective comments by the DRM who is not a qualified appraiser or qualified mineral appraiser.

ACTIVE OIL, GAS, AND MINERAL LEASES ON LE-0601 THAT REMAINED IN PLACE:

Oil & Gas VB-0831  
Holder: Rubicon Oil and Gas H. LP, 505 West Wall Ave, Ste 500, Midland, TX 79701  
Legal: S2 of Section 17, T17S, R37E, 2.026 acres  
Purpose: Oil and gas exploration  
Expires: 1/01/2011

Oil & Gas A-01573  
Holder: Landreth Production Corp, P.O. Box 1519Ft. Worth TX  
Legal: S2SW4 of Section 17, T17S, R37E, 80 acres  
Purpose: Oil and gas exploration  
Expires: 1/3/1934 (active well)

Oil & Gas VB0832  
Holder: Yates Petroleum, Artesia, NM  
Legal: S2SE4 of Section 17, T17S, R37E, 80 acres  
Purpose: Oil and gas exploration  
Expires: 1/1/2011

Oil & Gas B1505  
Holder: Devon Energy Corp, Oklahoma City OK  
Legal: SE4 of Section 21, T17S, R37E, 80 acres  
Purpose: Oil and gas exploration  
Expires: (active well)

All of the above active oil and gas lease holders were sent notice on July 8, 2009, which indicates that an exchange on the surface estate had been completed and that their leasehold interests would not be impacted and that their interest would continue with the New Mexico State Land Office. Those letters shown below as Exhibit "A" were in the file and made available. To date, none of the above lessees have contacted the New Mexico State Land Office indicating that their leasehold interest was or has been negatively impacted as the DRM suggested.

The auditors did not contact anyone from the Oil, Gas, and Minerals Division (OGMD) to discuss what meaning their comments on the creation of split estate were intended to convey to the Commissioner. Neither the Assistant Commissioner nor the Director of that division were consulted in an attempt to glean insight into the impact on the Oil and Gas leases. Considering the lengthy nature of this audit and that the OGMD is located in the same building, certainly at least **one** conversation with the parties would have been in order. During the more than two-year special audit, not a single auditor contacted relevant OGMD staff to determine if the companies had expressed any concern about the exchange and based this finding on the subjective opinion of the DRM rather a factual basis.

**RESPONSE TO DRM COMMENTS "LOSS OF MONEY & EXCHANGE DID NOT SERVE THE BEST INTEREST OF THE TRUST":**

A preliminary financial and market value analysis was completed and given to the Commissioner of Public Lands on June 27, 2008. This ***Report to the Commissioner*** (Report) provided a complete analysis and cited the reasons land exchange LE-0601 would be in the best interest of the trust. The Report, either verbal or written is presented to the Commissioner in Phase I, Due Diligence of the exchange. Once the Commissioner is provided with a written or oral report there is a discussion on the merits of the exchange with no legal requirement that there be meeting notes, or any other documentation of this discourse. At that point the Commissioner of Public Lands will decide if the exchange, in his estimation, is in the best interest of the trust. The Report shown below as Exhibit "B" was in the file and made available.

The auditor improperly chose to lend more credence to a field report that had no income based financial analysis, or the opinions of licensed appraisers, or other opinions of value from a DRM, and not to take the income analysis into account.

Following the closed land exchange, letters were sent to the two (2) beneficiaries on July 7, 2009; notifying them of the closed transaction and providing them with the details of the exchange and the reasons for the exchanges. A copy of the ***Beneficiary Summary Report*** is shown below as Exhibit "C." The beneficiary letters and summary reports were included in the file reviewed by the auditors, and give a clear synopsis of the exchange benefits to the beneficiary.



PATRICK H. LYONS  
COMMISSIONER

*State of New Mexico*  
*Commissioner of Public Lands*

310 OLD SANTA FE TRAIL  
P.O. BOX 1148  
SANTA FE, NEW MEXICO 87504-1148

COMMISSIONER'S OFFICE

Phone (505) 827-5760

Fax (505) 827-5766

www.nmstatelands.org

July 9, 2009

BP America Production Company  
P.O. Box 22048  
Tulsa, OK 74121

RE: New Mexico State Land Office Oil & Gas Leases #A01573.  
New Mexico State Land Office Exchange LE-0601  
Goff Dairy Land Exchange

Dear Lessee:

This is to inform you that the Commissioner of Public Lands has completed a land exchange with Kenneth Ivan and Beverly Jean Goff Trust, which resulted in the surface estate in certain State Trust Lands being conveyed to Kenneth Ivan and Beverly Jean Goff Trust.

The records of the State Land Office indicate that you are the holder of the above-referenced Oil and Gas Lease #A01573 and that this interest affects a portion of the State Trust Land that is involved in the above exchange transaction. The exchange transaction will be subject to your Oil and Gas Lease on lands located in the S $\frac{1}{4}$ SW $\frac{1}{4}$  of Section 17, Township 17 South, Range 37 East, N.M.P.M., Lea County, New Mexico, which means that your interest will continue in existence with the State Land Office.

The purpose of this letter is to inform you of the land exchange closed June 26, 2009.

Please do not hesitate to contact me at (505) 827-5762 if you have any questions regarding this matter.

Very truly yours,

Dallas Rippy  
Assistant Commissioner of Renewable Energy and Commercial Resource Division

cc: Exchange File LE-0601  
Oil & Gas Division, State Land Office

-State Land Office Beneficiaries-

Carrie Tingley Hospital • Charitable Penal & Reform • Common Schools • Eastern NM University • Rio Grande Improvement • Miners' Hospital of NM • NM Boys School • NM Highlands University • NM Institute of Mining & Technology • New Mexico Military Institute • NM School for the Deaf • NM School for the Visually Handicapped • NM State Hospital • New Mexico State University • Northern NM Community College • Penitentiary of New Mexico • Public Buildings at Capital •

LETTERS TO O&G LEASE HOLDERS



PATRICK H. LYONS  
COMMISSIONER

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*Commissioner of Public Lands*  
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P.O. BOX 1148  
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Fax (505) 827-5766  
www.nmstatelands.org

July 8, 2009

Rubicon Oil & Gas II, LP  
508 West Wall Ave  
Ste 500  
Midland, TX 79701

RE: New Mexico State Land Office Oil & Gas Leases #VB0831 0000  
New Mexico State Land Office Exchange LE-0601  
Goff Dairy Land Exchange

Dear Lessee:

This is to inform you that the Commissioner of Public Lands has completed a land exchange with Kenneth Ivan and Beverly Jean Goff Trust, which resulted in the surface estate in certain State Trust Lands being conveyed to Kenneth Ivan and Beverly Jean Goff Trust.

The records of the State Land Office indicate that you are the holder of the above-referenced Oil and Gas Lease #VB0831-0000 and that this interest affects a portion of the State Trust Land that is involved in the above exchange transaction. The exchange transaction will be subject to your Oil and Gas Lease on lands located in the S $\frac{1}{2}$ SW $\frac{1}{4}$ , SW $\frac{1}{4}$ SE $\frac{1}{4}$  of Section 16, Township 17 South, Range 37 East, N.M.P.M., Lea County, New Mexico, which means that your interest will continue in existence with the State Land Office.

The purpose of this letter is to inform you of the land exchange closed June 26, 2009.

Please do not hesitate to contact me at (505) 827-5762 if you have any questions regarding this matter.

Very truly yours,

Dallas Rippey  
Assistant Commissioner of Renewable Energy and Commercial Resource Division

cc: Exchange File LE-0601  
Oil & Gas Division, State Land Office

-State Land Office Beneficiaries-  
Curie Tingley Hospital • Charitable Penal & Reform • Common Schools • Eastern NM University • Rio Grande Improvement • Miners' Hospital of NM • NM Boys School • NM Highlands University • NM Institute of Mining & Technology • New Mexico Military Institute • NM School for the Deaf • NM School for the Visually Handicapped • NM State Hospital • New Mexico State Penitentiary • Northern NM Community College • Penitentiary of New Mexico • Public Buildings at Capital •



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Phone: (505) 827-5760  
Fax: (505) 827-5766  
www.nmstatelands.org

July 8, 2009

Yates Petroleum Corporation  
105 South Fourth Street  
Artesia, NM 88210

RE: New Mexico State Land Office Oil & Gas Leases #VB0832  
New Mexico State Land Office Exchange LE-0601  
Goff Dairy Land Exchange

Dear Lessee:

This is to inform you that the Commissioner of Public Lands has completed a land exchange with Kenneth Ivan and Beverly Jean Goff Trust, which resulted in the surface estate in certain State Trust Lands being conveyed to Kenneth Ivan and Beverly Jean Goff Trust.

The records of the State Land Office indicate that you are the holder of the above-referenced Oil and Gas Lease #A01573 and that this interest affects a portion of the State Trust Land that is involved in the above exchange transaction. The exchange transaction will be subject to your Oil and Gas Lease on lands located in the S $\frac{1}{2}$ SE $\frac{1}{4}$  of Section 17, Township 17 South, Range 37 East, N.M.P.M., Lea County, New Mexico, which means that your interest will continue in existence with the State Land Office.

The purpose of this letter is to inform you of the land exchange closed June 26, 2009.

Please do not hesitate to contact me at (505) 827-5762 if you have any questions regarding this matter.

Very truly yours,

Dallas Rippey  
Assistant Commissioner of Renewable Energy and Commercial Resource Division

cc: Exchange File LE-0601  
Oil & Gas Division, State Land Office

-State Land Office Beneficiaries-

Carrie Tingley Hospital • Charitable Penal & Reform • Common Schools • Eastern NM University • Rio Grande Improvement • Miners' Hospital of NM • NM Boys School • NM Highlands University • NM Institute of Mining & Technology • New Mexico Military Institute • NM School for the Deaf • NM School for the Visually Handicapped • NM State Hospital • New Mexico State University • Northern NM Community College • Institutions of New Mexico • Public Buildings at Capital



**EXHIBIT B**  
**REPORT TO THE COMMISSIONER**

New Mexico State Land Office  
Patrick H. Lyons, Commissioner of Public Lands



**MEMORANDUM**

TO: Dallas Rippy, Assistant Commissioner of Special Projects

Cc: Jerry King, Assistant Commissioner of CRD

FOR: Patrick Lyons, Commissioner of Public Lands

FROM: Dell Bearden, Management Analyst

RE: Proposed land exchange from Buster Goff, Goff Dairy, for a land exchange plus an additional cash bonus to the Trust of at least \$22,800 (20% of SLO land value)

Dated : June 27, 2008

**SUMMARY OF PROPOSED EXCHANGE:**

The State Land Office (SLO) received a letter from Buster Goff (dated 3/11/08) amending the *Initial Application for a Land Exchange*. Mr. Goff requested 760 acres of state trust land located north of Humble City and west of the Lovington Highway in Lea County which abuts his existing dairy operation. The amended proposal offers the State Land Office 760 acres of private fee land which abuts other state trust lands in the area. In addition, Mr. Goff offered a minimum cash bonus of \$22,800, which is 20% of the appraised value of the state trust lands.

**PURPOSE OF APPLICANT'S REQUEST TO EXCHANGE:** To expand the dairy and to create a buffer around their dairy facilities for Bio Security reasons.

**LEGAL LAND DESCRIPTIONS:**

**STATE TRUST LAND:**

*Township 17 South, Range 37 East:*

Section 16,	S2SW4 (80 ac), SW4SE4 (40 ac)	= 120 total ac
Section 17,	SW4 (160 ac), S2SE4 (80 ac)	= 240 total ac
Section 18,	SE4 (160 ac)	= 160 total ac
Section 21,	SE4 (160 ac)	= 160 total ac
Section 28,	N2NE4 (80 ac)	= 80 total ac
State		760 total acres

**FEE LAND:**

*Township 17 South, Range 37 East:*

Section 8,	S2NW4 (80 ac)	= 80 total acres
Section 17,	NW4 (160 ac); S2NE4 (80 ac)	= 240 acres
Section 19,	SW4 (160 ac)	= 160 acres
Section 20	NW4 (160 ac)	= 160 acres



Section 27	N2SW4 (80 ac), SW4SW4 (40)	=	120 acres
	Offered		760 total acres

**APPRAISALS UP-DATED 5/17/08 & APPROVED**  
**ARE BASED ON \$150/ac FOR BOTH SLO & DEEDED LAND:**

State Land (760 acres)	\$114,000 (\$150/ac)
Deeded Land (760 acres)	-114,000 (\$150/ac)
Difference in Land Value	\$ 00
Cash offer	<u>\$ 22,800</u>
Cash Bonus offered to Trust	<b>\$ 22,800</b>

**ECONOMIC CONSIDERATIONS:** Offered lands and state trust lands are within the same area and have been appraised as "like for like" values so there should be no increase or decrease in the annual grazing lease revenue. The minimum \$22,800 additional cash to be offered will be placed in the permanent fund. Based on a 5% assumption from the permanent fund deposit, the beneficiary should receive an additional \$1,150.00 in annual income.

**ENVIRONMENTAL CONCERNS & LAND MANAGEMENT**  
**CONSIDERATIONS**

Goff Dairy would like to block up their lands and provide a buffer around the Dairy. This exchange would also allow the Trust to remove land adjacent to the dairy operation to prevent any environmental damage from daily operation of the dairy and to acquire lands that are adjacent to existing State Trust Lands.

**OIL, GAS AND MINERAL REPORT ON STATE LAND:**

The Oil and Gas and mineral rights will remain with the State Land Office. The Oil, Gas & Minerals Division is concerned about split estate in a very active oil and gas leasing area. However, these state trust lands are adjacent to other state trust land and it does not appear these lands would be highly affected if production from the leases move forward to the drilling phase.

**CONCLUSION BY DIVISIONS STAFF ANALYSTS:**

Based on the information provided and division reports received staff recommends we proceed with the exchange.

**EXHIBIT C**  
**SUMMARY REPORTS TO THE BENEFICIARIES**

**Beneficiary Land exchanged to Kenneth Ivan and Beverly Jean Goff Trust**

<b>Beneficiary:</b>	Common Schools
<b>General Location and Description:</b>	This state trust land is located in an area adjacent to Goff Dairy operation north of Hobbs, New Mexico.  Section 16, S1/2SW1/4, SW1/4SE1/4 of Section 16, SW1/4, S1/2SE1/4 of Section 17, SE1/4 of Section 18, SE1/4 of Section 21, N1/2NE1/4 of Section 28, Township 17 South, Range 37 East, N.M.P.M, Lea County, NM, containing 760 acres, more or less.
<b>Size:</b>	760.00 ±acres
<b>Highest and Best Use:</b>	Agriculture land
<b>Appraised Land Value:</b>	\$114,000.00

**Kenneth Ivan and Beverly Jean Goff Trust exchanged to the State Land Office)**

<b>Owner:</b>	Kenneth Ivan and Beverly Jean Goff Trust
<b>General Location and Description:</b>	The offered property is located to the west of the Lovington Highway; near the Goff Dairy. The acreage is all in native vegetation and utilized for grazing.
<b>Legal Description:</b>	S1/2NW1/4 of Section 8, NW1/4, S1/2NE1/4 of Section 17; SW1/4 of Section 19; NW1/4 of Section 20; N1/2SW1/4, SW1/4SW1/4 of Section 27, Township 17 South, Range 37 East, N.M.P.M., Lea County, NM, containing 760 acres, more or less.
<b>Size:</b>	760.00 ±acres
<b>Highest and Best Use:</b>	Agricultural land
<b>Appraised Land Value:</b>	\$114,000.00
<b>Cash Portion of Transaction:</b>	\$ 22,800.00

Ag Lease Improvements:	\$ 6,806.00
Agreement:	\$143,606.00

**Reasons for proceeding with the Exchange:**

1. The Trust land was located directly adjacent to the dairy operation. Acquiring lands in the area but farther from the operation will lessen the chances of environmental damage to occur on Trust land.
  2. Acquired land will be leased for agricultural purposes. Annual rent income, going directly to the beneficiary, will be \$290.00. Revenue on the Trust land that was traded was approximately \$290.00. There is no loss or gain in the rental revenue.
  3. Goff Trust offered more than the appraised value of the land. Goff Trust offered \$136,800.00 for the state trust land (\$114,000.00 land value and \$22,800.00 cash bonus).
  4. The value of the improvements on the offered land is \$6,806.00. These improvements will be sold to the grazing lessee and the money will go direct to the permanent fund
  5. Based on a 5% annual interest assumption, this will increase the beneficiary's annual income from the permanent fund by \$1,480.00.
-

## **Finding 11– Failure to Consider Field Reviews (as amended)**

### **Condition**

We also noted ~~two~~ an additional exchange (EX-0405) 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 exchange. Despite these adverse recommendations, the Commissioner still carried out the exchanges. Again, we did not observe any documentation rejecting the recommendations and justifying why the Commissioner decided the transaction was in the best interest of the trust.

**RESPONSES TO “PRIME LAND & RECOMMENDATION AGAINST CONSUMATING THE EXCHANGE” LE-0405 RICO RANCH EXCHANGE:** The Exchange Staff and the Commissioner of Public Lands did consider the statement by the District Resource Manager as well as the opinions of other divisions who are contacted in Phase I Due Diligence prior to an exchange. The Commissioner welcomes input from all the divisions and weighs them very carefully. The District Resource Manager *did not* recommend against consummating the exchange as stated by the auditor, but recommended selecting other state lands to exchange. This was not an option the land office was able to consider because the applicant who owned the commercial property ideal for building a new middle school specifically wanted this section because it was encumbered by his cabin and other expensive amenities. The state land had poor access except through the applicant’s private land. Gallup-McKinley is a trust beneficiary and need land to lease for the purpose of a middle school. A more careful reading of that field report by the auditor would show that DRM Jeremy Kruger was inserting his personal bias into the report. The DRM was more concerned with the Ponderosa Pines and wildlife on that section than the financial impact to beneficiary. The DRM, who was not a licensed appraiser, even suggested to the Commissioner that the appraisal and valuation of the property would not take into account all the items he felt should be considered, rather than true value as determined by a licensed appraiser and as required by law. The Commissioner of Public Lands determined the exchange, as documented, was in the best interest of the trust and the auditor had access to this information in a Summary Report attached to the beneficiary letter which justified the Commissioner’s decision. For the auditor to give deference, and report a finding, based on subjective comments in a field report rather than facts, financial analysis, true value as determined by licensed appraisers, and the Commissioner’s estimation is troubling. The auditor elected to disregard the information and pick out the one negative comment by the District Resource Manager. Please see the justification in Exhibit “D” attached.

### **EXHIBIT D**

#### **SUMMARY REPORTS ATTACHED TO THE BENEFICIARIES LETTER**

#### **SUMMARY REPORT OF THE RICO RANCH EXCHANGE LE-0405**

#### **General Description of State Trust Land to be Exchanged**

**Beneficiary:** Common Schools

**General Location:** The State Land (beneficiary property) to be exchanged is located approximately 6.5 miles southwest of Thoreau, NM

**Legal Description:** All of Section 16, T13N, R14W, McKinley County, containing 640 acres, more or less.

**Highest and Best Use:** Agriculture

**Lease Income:** \$1,448.00

**Current Use:** Agriculture Lease, GS-2346 - \$502  
Business Lease (cabin) BL-1415 - \$945

**Appraised Value:** \$384,000.00

**General Description of Offered Land**

**Current Owner:** Michael Menapace, Rico Land & Cattle Company

**General Location and Description:** The offered land is located in the west part of Gallup, NM, adjacent the Gallup-McKinley high school. Access is via Rico Street.

**Legal Description:** Tract B, Sec. 26, T15N, R19W, McKinley County, 65.07 acres.

**Potential Income:** Between \$5,000 - \$6,000 annual income (potential lease to school)

**Potential Uses:** 40 acres for a middle school and open space for school  
20 acres for commercial potential

**Appraised Value:** \$520,000.00

**BENEFITS OF PROPOSED LAND EXCHANGE**

The State will increase the value of the trust asset by \$136,000.00. The appraised value of the State Trust land is \$384,000.00. The value of the offered land is \$520,000.

The Gallup McKinley School District owns land adjacent to the offered land. The school district is working as a third party to the exchange and would like to lease the land from the State Trust to build a third Middle School. The district cited several reasons why the land would be advantageous to the Gallup-McKinley School District.

- (1). The District has funded infrastructure (road, utilities, athletic facilities) to the high school and the adjacent lands would eliminate duplication of the cost for these improvements if the Middle School was built in another part of town.

- (2) The opportunity to lease land to build a 3<sup>rd</sup> middle school would be beneficial to create smaller classrooms which has proven to benefit the instructional process.

The NM PSFA has ranked the existing 2 Gallup middle schools in the top 100 out of almost 900 statewide for needs due to building, age, and use of portable buildings

and deteriorating structures. The opportunity for the district to lease this land from the

N.M.State Land Office will provide the needed space for a new middle school that would eliminate these deficiencies.

The Trust would increase annual revenue by approximately 5,500 by leasing the acquired acreage to the Gallup-McKinley School District for expansion of school facilities for a middle school.

Common Schools are the beneficiary so the excess income would go back toward funding education, thus making this a "win win" situation for both the Trust and the Beneficiary.

## **Finding 11– Failure to Consider Field Reviews (as amended)**

### **Condition**

Finally, we reviewed three ~~two~~ other exchanges (**EX-0504 and EX-0414 and EX-0405**) in which the SLO's OGMD recommended against the exchanges because doing so would create a split estate and would place the trust at risk of losing any future royalties, which are normally sources of substantial lease revenue. However, the Commissioner nevertheless consummated the exchanges and it does not appear that the Division's recommendations were considered. We did not observe any documentation rejecting the recommendations and justifying why the Commissioner decided the transaction was in the best interest of the trust.

### **RESPONSE TO OGMD COMMENTS "REGARDING SPLIT ESTATES BY THE ASSISTANT COMMISSIONER OF THE OIL, GAS AND MINERAL DIVISION:**

First, the statement above "...OGMD recommended against the exchanges because doing so would create a split estate and would place the trust at risk of losing any future royalties..." is again patently false. In no way do any of the memoranda on LE-0504, LE-0414, LE-0405 make any recommendations on the exchange or comment on a loss, or risk of loss, for future or current royalties. Rather, the memoranda state factual matters such as the geologic formations which have the potential for production, royalty that would result if the resource was fully developed based on current rates, that split estate "complicates" development of the minerals, and the opinions of the staff from their singular focus of the impact on the mineral estate.

Second, the auditors did not contact anyone from OGMD to discuss what meaning their comments on the creation of split estate were intended to convey to the Commissioner. Neither the Assistant Commissioner nor the Director of that division was consulted in an attempt to glean insight into their comments. Considering the lengthy nature of this audit and that the OGMD is located in the same building, certainly at least **one** conversation with the parties making those comments would have been in order. Instead, the auditor chose to insert their subjective interpretation and inferred the intent of the commenting parties.

The Land Office and the OGMD routinely deal with split estate because there are currently approximately 13,000,000 mineral acres and 9,000,000 surface acres of trust property, meaning there are about 4,000,000 split estate acres. This significant amount of split estate was created many years ago as previous land commissioners sold surface estate while the mineral estate remained with the Land Office because the mineral estate cannot be sold or exchanged, except to the Department of the Interior (BLM). So split estate has been a fact of life in the oil and gas operations at the Land Office for many years.

As part of the exchange process oil and gas personnel are tasked to review exchanges and provide their input and perspective to the Commissioner so that a full understanding of all issues can be developed. The oil and gas perspective is their narrow focus on how the exchange may impact oil and gas operations. Oil and gas personnel do not have the overall knowledge or understanding of the benefits of the potential exchange to the trust and do not have the expertise, training or experience to decide if the exchange is in the

best interest of the trust as a whole. That decision rests solely with the Commissioner of Public Lands after the input from all departments.

OGMD routinely comments in its consideration of any private exchange that split estate will be created. This is a fact that exists with every private exchange and is a fairly benign comment because there are already 4,000,000 split estate acres - it is never intended to suggest that an exchange should not occur because of newly created split estate. Split estate is encountered and dealt with on a routine basis within oil and gas and does not cost the trust revenue from oil and gas operations because the trust retains the mineral interest after exchanges and deals with the newly created split estate as it does the other 4,000,000 split estate acres already in the system. Oil and gas leases on split estate are routine and exchanges during the Lyons administration have not cost the trust any oil and gas revenue loss.



**STATE OF NEW MEXICO  
NEW MEXICO STATE LAND OFFICE**



**COMMISSIONER'S RESPONSE TO  
FINDING 12**

**Patrick H. Lyons  
Commissioner of Public Lands  
December 17, 2010**

**FINDING 12- Failure to notify beneficiaries of application to purchase state trust land.**

**Facts-** Rule 19.2.14.8(A) NMAC requires notification to beneficiary institutions upon receipt of any application to purchase.

**Response-** During this administration and previous administrations, the commercial division has notified the beneficiary that dedicated lands have been sold only after the sale was completed, which is a practice contemplated by the land exchange rule (see 19.2.21.13(B) NMAC). The practice has persisted with respect to both sales and exchanges partly because the commercial division was not aware of the difference in the sale rule and the exchange rule and partly because hundreds of proposed transactions are never consummated and informing the supported institution immediately upon receipt of an application seems premature and illogical.

While the sale application notice requirement is grossly inefficient, the land office should comply with it. We are recommending that the next administration comply with the sale application notice requirement in a timely way, until such time as the sale rule is amended to conform to the exchange rule. The commercial division and the legal division agree that notification for both sales and exchanges should be uniform. OSA should note that during Commissioner Lyons' tenure, the land office has never had a supported institution complain about receiving formal notice of a sale or exchange after the transaction was completed. On the contrary, supported institutions have repeatedly praised Commissioner Lyons' performance during Advisory Board meetings. Attached you will find a copy of our final meeting minutes. Comments from supported institutions have been highlighted for your convenience.

**STATE OF NEW MEXICO  
NEW MEXICO STATE LAND OFFICE**



**COMMISSIONER'S RESPONSE TO  
FINDING 13**

**Patrick H. Lyons  
Commissioner of Public Lands  
December 17, 2010**

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

The purpose of an appraisal for a transaction involving Trust lands is to estimate the *market value* of the subject property.

The two standard approaches for estimating the *market value* of vacant land are the *sales comparison approach*, which is almost always applicable, and the *income capitalization approach*, which is only applicable when buyers base their purchase decisions on such.

The income potential of the Trust lands involved in the Stanley Ranch exchange was fully considered by the appraiser, but disregarded as a viable indicator of value, since none of the 64 confirmed sale properties in northern New Mexico and southern Colorado provided by the appraiser were found to have been purchased on an income basis.

In other words, buyers do not use potential income from hunting permits or any other source as the basis for purchasing land in the Whites Peak area.

Furthermore, it is obvious the State Auditor does not understand the income (capitalization) approach, as the recommendation to use it for valuing the subject lands is based solely on an estimate of gross income without considering how it relates to *market value*.

The basic formulas for converting real property income into value are:

$$\begin{array}{lcl} \text{Net Income} & = & \text{Gross Income} - \text{Operating Expenses} \\ \text{Market Value} & = & \text{Net Income} \div \text{Capitalization Rate} \end{array}$$

Several sources, including representatives of Farm Credit, recreational land appraisers, and local brokers, confirmed that *minimum* operating expenses for this type of business would be 50% of the gross income, and that an appropriate capitalization rate would be *no less than* 20%.

Using the Auditor's *speculative* gross income estimate of \$840,000, subtracting operating expenses of \$420,000 (\$840,000 x 50%), and dividing the result by 20%, indicates a value for the subject property of **\$2,100,000**.

Using the sales comparison approach, the Land Office appraiser estimated the *market value* of the same land at **\$6,353,000!** Needless to say, this entire finding is absurd.

**STATE OF NEW MEXICO  
NEW MEXICO STATE LAND OFFICE**



**COMMISSIONER'S RESPONSE TO  
FINDING 14**

**Patrick H. Lyons  
Commissioner of Public Lands  
December 17, 2010**

#### **FINDING 14- Lack of Financial analysis on land transactions**

**Assertion-** The state auditor claims that all sales and planning and development leases tested during the examination lacked financial analysis and all planning and development leases contain improvement value credits and determination of those credits are not supported by written financial analysis.

**Response-** The first claim is simply factually incorrect. A brief review of the file in response to the audit report revealed financial justifications for nearly all completed sales and exchanges. In exceptional cases, it is possible that documents were misplaced or misfiled. It is certainly not a systemic problem nor should it constitute a finding for the purposes of this review. The office of the State Auditor should note that the financial analysis is contained within the beneficiary letter and provides a breakdown of the reasoning for ultimately executing the sale. Once again, after two and a half years of scrutiny, the state land office would expect and frankly the taxpayers deserve a more comprehensive review.

The recommendation to create a financial analysis for all planning and development leases illustrates a fundamental misunderstanding with regard to how these instruments are utilized and created. Planning and development leases are collaborations between the real estate community and the government that allow developers to pay for the right to attempt to increase the value of state trust lands. If successful, the developer gets to share in the profits of that collaboration based on the increase in land value. The split or profit share is based on negotiations between the parties, and the Commissioner's

split is determined by what the market will bear, not some predetermined analysis by the land office staff, which would be useless in these negotiations because our office doesn't know before the developer actually begins his work how that development will progress.

When Commissioner Lyons took office, the only planning and development lease was concerned Mesa Del Sol development, and the state land office's share or split was fourteen (14) percent. Commissioner Lyons thought that was too low and, as a policy, will not take less than forty (40) percent. Most planning and development leases provide the land office a sixty (60) percent share or split, but they do vary. The State Auditor refuses to acknowledge the Commissioner's decision -making authority and seeks to replace it with that of his staff.

**STATE OF NEW MEXICO  
NEW MEXICO STATE LAND OFFICE**



**COMMISSIONER'S RESPONSE TO  
FINDING 15**

**Patrick H. Lyons  
Commissioner of Public Lands  
December 17, 2010**



## **Response to Finding 15 - Lack of Formal Policies and Procedures for Improvement Value Credits**

### Introduction

The use of planning and development leases to increase the value of state trust land precedes this administration. This administration vastly increased the land office's share of the increased value, which is realized upon a subsequent sale, exchange or long-term lease of the land. After issuance of Attorney General Opinion 08-02, which questioned the commissioner's authority to provide lessee's with improvement value credit (IVC) for planning and development work, the commissioner obtained legislation (NMSA 1978, § 19-7-9(C) (2009) and promulgated a rule (19.2.22 NMAC) which provides specific authority and a regularized bid process for issuing P&D leases and granting planning and development credit (PDC) to the lessee. OSA chose to provide no input on the proposed legislation or the proposed rule. The audit report nonetheless incorrectly finds a lack of formal policies and procedures for determining how the former IVC (and presumably the new PDC) is to be calculated, and fails to identify what the missing policies and procedures might be.

Because the desirability of a planning and development lease varies depending on the location of the land, the local regulatory environment and general economic conditions, there is no way to establish a single IVC or PDC percentage for all P&D leases. These P&D leases are largely unique to state trust lands, and thus there is no external "market" for P&D leases that can be assessed for purposes of determining a "market" IVC or PDC. The determination necessarily has been left to the discretion of the commissioner, who negotiated with potential lessees to assess what percentage would attract interest from responsible and capable developers, and now employs a public auction. The only other options is to forego P&D leases and to revert to a failed internal planning and development process or leave highly developable trust land undeveloped.

Because the legislature has authorized P&D leases and the commissioner has promulgated a rule in accordance with this rulemaking authority, OSA lacks any legitimate basis for questioning the P&D leasing process or whether it complies with the Enabling Act.

The audit report is particularly misguided in its suggestion that the IVC or PDC percentage should be determined only after the lessee has done all of the work for which it seeks compensation. The audit report identifies no other situation where a party's rate of compensation for work is determined only after the work is completed, and the very notion defies common sense and experience. Nor does the audit report identify any situation where an essential term of a lease is left open and determined only when the lease terminates. Again, the audit report reaches beyond the proper purview of OSA and presupposes the illegitimacy of P&D leases authorized by the legislature and land office rules.

**STATE OF NEW MEXICO  
NEW MEXICO STATE LAND OFFICE**



**COMMISSIONER'S RESPONSE TO  
RISK OBSERVATION 01**

**Patrick H. Lyons  
Commissioner of Public Lands  
December 17, 2010**

## **Risk Observation 01 – Notice to Beneficiary Institutions**

### **SLO Response:**

The auditors claim in "Risk Observation 01 – Notice to Beneficiary Institutions" is patently false. Below is a table listing all of the exchanges, the date on which they closed and the date on which the letter to the beneficiary institution was mailed. A copy of the each letter is attached below the table for reference. In most cases the beneficiary was notified promptly. Of the 34 exchanges, beneficiary letters were mailed often within days of the exchange, many times prior to the exchange closing, and only in exchange LE-0409 were the letters as late as suggested in the risk observation.

It is important to note that LE-0610 was electronically imaged shortly after the exchange closed. The scan shows that at the time the record was submitted into the SLO records division, the beneficiary letter was in the document. The only parties who have accessed that land exchange file since it was scanned are the attorney general and the state auditor. Unfortunately, an electronic image of all the exchanges has not been completed. Had that been done the file would show that letters were mailed and included in the file. However, the procedures and policies ensuring that all beneficiaries are given timely notice are already in place.

Additionally, meetings with the beneficiary institutions are held yearly at the SLO. No beneficiary institutions have ever raised concern about how the Commissioner has conducted land exchanges or sales.

	LAND EXCHANGES		
		Date Exchange Closed	Beneficiary Letter Mailed
LE-0304	Double H	10/24/2003	10/14/2003
LE-0311	Felix River	8/12/2004	7/19/2004
LE-0310	City of Deming	8/25/2004	4/22/2004
LE-0308	IMC Kalium	10/27/2004	1/20/2003
LE-0402	Roswell Gun Club	1/28/2005	12/7/2004
LE-0405	Rico Motor	4/5/2005	2/7/2005

LE-0305	Sandia Escarpment	7/7/2005	1/16/2004
LE-0412	Rio Rancho Exchange	7/7/2005	6/20/2005
LE-0413	Orozco Exc.	8/25/2005	8/24/2005
LE-0414	Las UVAS Valley Dairy	12/27/2005	12/22/2005
LE-0415	Albuquerque Public Schools (APS) 1st Exchange	2/3/2006	2/21/2006
LE-0508	Katerina Exchange Sec 16	5/31/2006	7/31/2006
LE-0504	McCall Exchange	8/2/2006	8/1/2006
LE-0302	UNM/MDS Exchange	5/31/2006	No Beneficiary Letter necessary/land was traded to UNM the beneficiary
LE-0609	UNM Campus Exchange	10/17/2006	10/26/2006
LE-0510	COA/ Eclipse Exchange	11/3/2006	8/23/2007
LE-0513	NM SVI School of Visually Handicapped 1st Exchange	10/23/2006	11/30/2006 not attached
LE-0610	Section 1 Dona Ana County Exchange	4/10/2007	5/29/2007 not attached
LE-0409	L-Bar (K.Burns)	8/30/2007	7/6/2010 Auditors site this as 6 notices as if we were late on 6 exchanges. It is only 1 exchange.
LE-0708	APS 2nd School	2/20/2008	3/5/2008
LE-0715	Hot Springs Development LLC	4/16/2008	5/8/2008
LE-0701	Brunson Land Exchange	8/11/2008	8/18/2008
LE-0606	Bowlin Travel Center Inc	8/27/2008	10/30/2008
LE-0506	Dave Farr	11/29/2008	12/10/2008
LE-0403	Moriarty Airport Exchange	4/20/2009	4/23/2009
LE-0601	Goff Dairy Exchange	6/26/2009	7/7/2009
LE-0501	Santa Maria El Mirador	8/25/2009	10/13/2009
LE-0907	Union Pacific RR	11/12/2009	12/8/2009
LE-0713	Ocate Exchange (Stanley)	1/7/2010	Supreme Court order issued before beneficiary letter was drafted
LE-0704	Church of Spiritual Technology	12/18/2009	12/29/2009
LE-0709	City of Eunice	1/9/2010	1/18/2010
LE -0905	Lea County EDC (Isotopes)	4/21/2010	7/19/2010
LE-0902	Belcher Land Exchange	6/25/2010	8/12/2010

It is important to note that LE-0610 was electronically imaged shortly after the exchange closed. The scan shows that at the time the record was submitted into the SLO records division, the beneficiary letter was in the document. The only parties who have accessed that land exchange file since it was scanned are the attorney general and the state auditor. Unfortunately, an electronic image evidencing that letters were mailed and included in the file of all exchanges has not been created. However, the procedures and policies ensuring that all beneficiaries are given timely notice, are in already in place,

Additionally, meetings with the beneficiary institutions are held yearly at the SLO. No beneficiary institutions have ever raised concern about how the Commissioner has conducted land exchanges or sales.

<b>Land Sale</b>	<b>Date sale closed</b>	<b>Date letter was mailed to beneficiary</b>
LS-5938	1/12/2006	3/22/2006
LS-5951	2/22/2008	Missing from file
LS-5963	4/15/2008	4/17/2008
LS-5971	8/27/2009	9/30/2009
LS-5974	7/29/2009	10/16/2009
LS-5975	10/20/2009	10/21/2009
LS-5941	11/23/2009	Missing from file
LS-5980	2/20/2010	2/11/2010
LS-5987	11/17/2010	11/23/2010
LS-5985	11/18/2010	11/23/2010
LS-5988	11/19/2010	11/29/2010

**STATE OF NEW MEXICO  
NEW MEXICO STATE LAND OFFICE**



**COMMISSIONER'S RESPONSE TO  
RISK OBSERVATION 02**

**Patrick H. Lyons  
Commissioner of Public Lands  
December 17, 2010**

## **Risk Observation O2 – Trust Lands Not Included In SLO Audit Reports**

Trust lands cannot be included in the SLO Audit Reports. To do an appraisal of all 13 million acres each year would take at least 10 employees and a 2 million dollar budget. This would not only unnecessarily burden the state land office it would reduce revenues for the supported institutions of the trust. This recommendation typifies bigger and less effective government.

This is a prime example of the office of the State Auditor (OSA) providing advice or recommendations that are void of any realistic value to any administration. It is clear that OSA did not review pertinent documents or properly inquire about what is being done with respect to all trust assets. Attached you will find Western State Land Commissioner Schultz's comments. The report clearly states that your recommendation is "unattainable and unnecessarily costly". Had OSA read the report it would have found a number of possible solutions posed such as, creating a special auditing category as they do for national parks (heritage assets) or providing clarifying language in GASB 4.

Under the leadership of past President Patrick H. Lyons, the Western States Land Commissioners Association (W.S.L.C.A.) funded a pilot project in Wyoming, Idaho and Oregon to review these issues. The W.S.L.C.A. will be compiling these results. This is an example of addressing another very tough and expensive issue at no cost to the supported institutions.

It is improper to list a risk observation to alleging a need for reform regarding an issue Commissioner Lyons has been working on with other Western Land commissioners for years.



Thomas M. Schultz, Jr.  
President, WSLCA  
Administrator,  
Trust Land Management Division  
Montana Department of  
Natural Resources & Conservation



1625 Eleventh Ave.  
PO Box 201601  
Helena, MT 59620-1601  
(406) 444-4978 phone  
(406) 444-2684 fax

August 12, 2010

Governmental Accounting Standards Board  
Attn: Mr. Randal Finden, Project Manager  
401 Merritt 7, P.O. Box 5116  
Norwalk, Connecticut 06856

**Subject:** Fair Value Measurement Research Project

Dear Mr. Finden:

The Western States Land Commissioners Association (Association) appreciates the opportunity to comment on the GASB Fair Value Measurement Research Project. We also appreciate the time you took to participate in a conference call during our recent association asset management committee meeting. These discussions appear the first in a series of important dialog necessary for the GASB to better understand the variety of state land management objectives that exist. For reasons detailed in this letter, the Association believes the GASB goal to standardize the reporting of all state land holdings based on year-to-year changes in "investment" value, given the disparate missions that exist, is an unattainable and unnecessarily costly position for states. Continued reporting of trust land assets, and a variety of other state lands, under the provisions of GASB 34 – Capital Asset Accounting, appears the most appropriate and consistent treatment.

### Background

As you know, the Association consists of 23 states which together manage 447 million acres of land, mineral right properties, and land beneath navigable waterways. The unique nature of these state trust lands is bound in the history of the formation of each state. As an incident of statehood, most states west of the Mississippi River received grants of federal land to assist in the funding of public education facilities and other governmental programs. Known as school lands, trust lands or grant lands, these properties were scattered throughout the various states. As granted lands, the new states expended no public funds or resources to acquire them.

The grants by which the states were given the lands represent solemn trusts. These trusts provide that proceeds from sale or use of the land be applied specifically to education and other various purposes. Thus, these lands may not be used without compensation to the beneficiary. Many states have laws or constitutional limitations on the disposal (lease, sale, or exchange) of these assets as well as the usage of proceeds from land sales. The purchase of lands with trust land revenues is also limited in some states.

State trust lands are managed by state agencies called land offices, land commissions or land boards -- collectively identified as commissioners. Five are headed by statewide elected officials. Following is a more detailed description of state trust lands:

**School lands/ Trust lands / Granted lands** - Most western states received grants of federal land when they became states. These land grants were given to the states to generate income for public education and other state programs. States are required by law to use trust lands for those purposes and with strict loyalty to specific beneficiaries. Due to the nature of the grants, these lands are often scattered and diverse. Most are forest, grazing or agricultural land. A have seen their once rural lands encompassed by urban development which presents new opportunity and challenges. Some states received two sections in each township (640 acres to a section); others received four sections. If these lands were not available due to previous grants by Congress (e.g. Indian reservations, forest reserves, military reservations) the states were granted other lands 'in lieu' of the original land grants. Some states are still selecting 'in lieu' lands from federally owned land.

Most land commissioners also manage lands under navigable waterways to protect resources and, in some cases, to produce revenue. These lands, often called public trust or sovereign lands typically have a very different mission as detailed in the following text:

**Sovereign lands / Public trust lands** - State land managers administer lands that lie below the ordinary high water mark of navigable lakes and rivers. These lands were granted each state under what the federal courts have called "the equal footing doctrine". This doctrine establishes that each state entering the union enjoys the same rights afforded the original thirteen. Since the King of England owned these sovereign lands in the pre-Revolutionary War colonies, the states gained ownership upon the surrender of the King. Sovereign lands are managed for the protection of navigation, commerce, fish and wildlife habitat, aquatic beauty, public recreation, and water quality. Leases or easements on these lands can be a source of revenue to states. Depending on each state's constitution and statutory authority, revenues may be applied to the state General Fund or to specific beneficiaries.

Many states also designate lands in reserve or receive lands in trust for a variety of purposes. Examples include lands reserved or donated for state parks. Some states may also receive and manage land donated by energy producing companies or development companies as part of a wildlife mitigation trust fund. These represent lands of the state that are also managed under specific conditions or that are administered through a trust fund mechanism. We assume state controllers or state treasurers are reporting some of these assets as reserved or restricted in the appropriate Governmental or Proprietary Fund type. The Association mentions these lands simply to illustrate the variety of state lands and the disparity of purpose associated with state land management.

## Discussion

The Association asked its members to review and comment on the purpose and objectives of the Fair Value Measurement Research Project. Participation in the recent conference call with GASB representatives and follow-up discussion were used to formulate the Association's view regarding the potential classification of all state land as an "Investment" subject to annual valuation. Some states also may have chosen to respond directly to GASB.

- **State trust lands do not meet either GASB 31 or GASB 52 criteria to be designated as an Investment subject to fair value measurement, and as such, should not be treated the same as real estate assets of university endowments and pension plan assets.**

As explained above, these lands were not acquired through purchase but rather granted, at no cost, to the states at statehood. The Admission Act of each state describes the location, amount, and purpose of the grant. In many cases, decades passed before all the lands were surveyed and transferred to the states from the federal government. At statehood, the federal government did not assign a value to the land.

GASB and FASB alike, traditionally define investments as financial assets or assets that, due to their marketable nature, can impact earnings and influence financial statement users decisions regarding potential investment. As stated above, state trust land does not meet the definition of investment and, as discussed later, financial statement users such as bond rating companies or the general public cannot compel a government to liquidate these assets for alternative investments.

Conversely, endowments acquire lands with funds from gifts or earnings. The land has a basis value equal to the amount paid or value assigned at the time of donation. Often these lands are liquidated and converted to financial instruments.

- **State sovereign lands, or public trust lands, do not meet either GASB 31 or GASB 52 criteria to be designated as an Investment subject to fair value measurement.**

Public trust lands were typically granted to states by the federal government to fulfill a variety of public commerce and recreational objectives. Such lands may or may not have a multiple use mandate and may or may not generate revenue. The constitutional language granting public trust lands and designating beneficiaries can be quite different. Similar to state trust lands, public trust lands were provided by the federal government without an assigned land value. They represent fixed assets of the state, are most often held in perpetuity, and are not sold to capture investment value. If the trust land were to be converted to a monetary asset these proceeds would be subject to existing GASB standards.

- **Constitutional language for state trust lands defines who benefits from the assigned grants and who, therefore, has legal standing to hold the trustee accountable for performance.**

One stated goal of the Fair Value Measurement project is to provide financial statement users with information about alternative investments and resources available to governments. As previously mentioned, state trust lands are designated to specific beneficiaries. Only those beneficiaries hold legal standing to assert claims against the trustee for a violation of prudent fiduciary practices. Therefore, neither bond rating companies nor the general public could compel the board to sell land based on a change in value presented in a financial statement. To liquidate real estate from year-to-year based solely on a change in land value would violate prudent fiduciary standards.

- **The state trust land asset is not liquid; disposal of trust lands is closely controlled in each state. The timing of sales, if allowed at all, cannot be used to distort fund earnings.**

One state reported that state law requires that the forestland base be maintained in perpetuity so establishing a fair market value of these lands serves little purpose since the value cannot be captured through sale and reinvested. In most states land sale proceeds are passed to the permanent fund; often a separate agency who does manage an investment portfolio comprised of mostly financial instruments and who is subject to GASB investment reporting standards. Some states possess a land bank fund to allow reinvestment of land sale proceeds in other lands or to improve the value of existing trust lands.

- **For state trust land managers, policy makers, and beneficiaries there are equivalent or better performance measures than land value-based measures to determine what constitutes acceptable performance.**

Beneficiaries are most interested in steadily increasing, inflation-proofed *earnings* from the land rather than changes in land value because many states distribute earnings less expenses. Some states put all land management earnings into a reserve fund and make periodic distributions based on policy or formula. The land is viewed as the 'seed corn' that produces the benefit. Therefore, performance metrics such as net revenue per acre, management cost per full time equivalent or management cost as a percentage of revenue and variance analysis (a discussion of planned revenue and cost versus actual results) are likely to produce more understandable and relevant data for judging performance.

Some annual reports generated by land offices, not the high-level state CAFR, already report a suite of performance measures that help beneficiary users understand their individual trust performance. Likewise, the Association has for several years encouraged a pilot reporting project in an attempt to demonstrate comparability between state trust land managers. The Association has found through this effort that comparability is difficult given the subtleties of each state's constitutional language and missions.

- **Obtaining up-to-date land value information is costly, accuracy varies from state to state, and data is difficult to keep current and timely.**

The states manage 447 million acres of land and mineral interests scattered among numerous parcels and tax lots across the 23 western states. Recent experience by one state land manager resulted in a nine-month project at a cost of \$500,000 to complete a mass appraisal to obtain estimated land values by region and asset type to facilitate pricing for leases and easements. The state reported that despite the cost and time expended, the work would not result in a market value appraisal product. Other states reported similar efforts underway through modeling or a combination of mass appraisal and best professional judgment. And finally, another state said the cost of appraising its 3,421,153.47 surface acres could be well over \$20,000,000.

There is also the matter of the subsurface estate. Many states gain considerable revenue from royalties charged for the production of oil, gas, coal and other minerals considered as subsurface estate resources. In some cases these resources are owned independent of the ownership of the surface estate (so-called 'split estate' lands). There are millions of acres of mineral production land among the 23 member states in the Association. All of these resources would need appraisals as well and with the volatility of the minerals market the appraisals and valuations would need to be performed every year. Performing reserve studies for oil and gas alone is very detailed. One state with a modest amount of mineral production activity estimated an analysis of the producing properties could cost between \$500,000 and \$700,000 with annual reviews costing \$100,000. There is also a shortage of well-trained mineral appraisers.

It was suggested during our conference call in July that using discounted cash flow (DCF) models could be used to determine the value of the mineral estate. Similar to appraisals, DCF models can be quite costly and complex to develop. We question the usefulness in this case since a meaningful valuation using DCF requires a fairly reliable reserve estimate for the cash flow to be determined.

Expenditure of funds for costly annual valuation studies or to develop financial models does not help beneficiaries pay teacher salaries, buy schoolbooks, or allow the state to purchase additional wildlife habitat for preservation and to enhance state parks.

- **There are no entities comparable to state trust land managers; comparison with private entities or endowment or permanent fund managers is fundamentally flawed.**

As an example, the trust lands of the northwest states are dominated by forests and the most comparable entity possessing substantial timber assets are Real Estate Investment Trust (REIT) organizations. The financial statements of several prominent timber REIT's (notably Potlatch Corporation and Plum Creek Timber Company) report timber and timberlands consistent with the treatment of Plant Property and Equipment (capital assets); at historical cost net accumulated depreciation. Private investors and endowments funds that purchase the common stock of the REIT would be subject to fair market value reporting, however the REIT would not report its lands as a market investment.

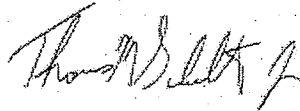
- Should GASB consider establishing a special asset category for state lands?

During our conference call, it was suggested that perhaps a special designation should be established for state trust land similar to how the Federal Accounting Standards Advisory Board has classified national parks and other sensitive lands as Heritage Assets or Stewardship Lands. The term Legacy Assets was suggested.

While this may be a solution, we suggest a better option is simply to provide clarifying language in GASB 34 – Capital Asset Accounting. Most land assets of the states, whether it is granted land, public trust land, state parks, etc., are reported as capital assets of the state in the governmental-wide financial statement. Clarifying the types of “land” to report through the GASB 34 implementation guide would be an easy solution. The Association believes continued capital asset treatment of these state lands is the appropriate reporting standard.

Thank you for the opportunity to comment on the Fair Value Measurement project. The Association supports continued dialog toward an informed solution on behalf of our user beneficiaries.

Sincerely,



Thomas M. Schultz Jr.  
President, WSLCA

TS/KJO

cc: All state commissioners and directors  
Elinor Schwartz, Washington DC Representative, WSLCA

**STATE OF NEW MEXICO  
NEW MEXICO STATE LAND OFFICE**



**COMMISSIONER'S RESPONSE TO  
RISK OBSERVATION 03**

**Patrick H. Lyons  
Commissioner of Public Lands  
December 17, 2010**

### **Risk Observation 03- Failure to Adhere to Publicized Bid Process.**

**Facts-** The state land office sent out a request for proposals (RFP) seeking planning and development proposals regarding lands within the Las Cruces Extraterritorial Zone. The Commissioner did not specify any particular tract and was not required to do an RFP. However, he thought there might be interest from other developers. Las Cruces, at the time, was an emerging market and development was booming. When the RFP went out the initiating developer offered to execute a Planning and Development lease for a portion of the Las Cruces Extra-Territorial Zone lands and also to master plan the remaining trust lands in the Extra-territorial zone at no cost to the land office. This was never contemplated, had never been done in the past, and constituted incredible value for the trust. After a thorough review and consultation, Commissioner Lyons accepted the offer.

**Response-** This transaction generated \$116,437 in lease revenue for the trust as well as surveys, traffic studies and master plans for the trust lands in the Las Cruces Extra-Territorial, Zone at no cost to the land office. The developer has since defaulted, and all lands are available to re-lease, exchange or sell. In retrospect it would have been prudent to wait until all bids were submitted and reviewed before entering into a lease. In the months that followed the public perception was that the land office did something wrong. Nothing could be further from the truth. This was a fantastic deal for the trust. While the process could have been more transparent the audit report should note that the result has provided substantial benefits to the trust



**STATE OF NEW MEXICO  
NEW MEXICO STATE LAND OFFICE**



**COMMISSIONER'S RESPONSE TO  
RISK OBSERVATION 04**

**Patrick H. Lyons  
Commissioner of Public Lands  
December 17, 2010**

#### **Risk Observation 04 – Code of Conduct and Conflicts of Interest**

**Facts:** October 24, 2002 Commissioner Powell filed a Code of Conduct with the Secretary of State's office. On May 26, 2009, Commissioner Lyons filed a Code of Conduct exactly matching the Code filed in 2002. At all times, employees of the State Land Office have been subject to an internal Code of Conduct.

**Legal Analysis:** The New Mexico Statute which governs codes of conduct is NMSA § 10-16-11 which states, "By January 1994, each elected statewide executive branch officer shall adopt a general code of conduct for employees subject to his control." The Commissioner of Public Lands, by January 1994 adopted a general code of conduct for State Land Office employees. The statute also requires that the code of conduct "be reviewed at least once every four years." The statute does not require each new Commissioner of Public Lands to adopt his own Code of Conduct, it merely requires the Code of Conduct be reviewed on a consistent basis. The Auditor has presented no evidence that this review did not occur. The only time a code of conduct is required to be filed with the Secretary of State is when it has been amended. The statute does not set forth that a code of conduct must be filed every four years. Therefore, the Commissioner acted within the boundaries of the law when he filed his code of conduct in 2009.

The Auditor recommends that the Commissioner and SLO management "develop and implement written policies and procedures to address reported or unreported conflicts of interest by SLO employees." The Commissioner and SLO management have already

developed and implemented written policies and procedures – it is the SLO's Code of Conduct, which has been in full force and effect.

The SLO's code of conduct does not allow an employee to own a contractual right that is handled by that employee's division unless special permission has been granted. There are no conflict of interest special requests on file.

If an employee does own an interest in a lease, easement or other contractual right which is not serviced by his or her division, that employee may apply in writing to request special permission from the Commissioner to continue to own the contractual interest. The commissioner may grant such permission if he determined that no conflict of interest is present.

If an employee, or any member of that employee's immediate family, is a SLO lessee or an applicant for a State Land Office lease, or has an ownership interest in any other business or employment, or prospective employment for which negotiations have already begun, which the employee believes or has reason to believe may be affected by his or her official acts or by actions of the SLO, the employee shall disclose the precise nature and value of such interest in writing to the Commissioner as soon as that interest arises. The employee shall also disclose in writing to the Commissioner when such interest ceases. There are four such conflict of interest forms on file. Those forms have been acknowledged by the Commissioner.

All SLO employees are required to fill out a conflict of interest form if they have a financial or other interest that he or she believes or has reason to believe may be affected by the actions of the SLO. In addition, anyone who has any other conflict of interest shall disclose the precise nature and extent of such interest in writing to the

Commissioner as soon as the interest arises. There are three financial conflict of interest forms and three other conflict of interest forms on file. All forms have been acknowledged by the Commissioner.

There are approximately 150 employees at the State Land Office, only 10 employees needed to disclose any interest which may be a possible conflict of interest.

Furthermore, it should be noted at the time a person begins employment at the SLO, he is given a copy of the code of conduct and is required to read it.

**STATE OF NEW MEXICO  
NEW MEXICO STATE LAND OFFICE**



**COMMISSIONER'S RESPONSE TO  
RISK OBSERVATION 05**

**Patrick H. Lyons  
Commissioner of Public Lands  
December 17, 2010**

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

While the audit report finds no violation of any law, campaign practice regulation or other statute, it offers opinions about what another branch of the government-- in this instance, the Legislature-- might do with regard to new laws-- in this instance, laws that would apply to the SLO. Of course the State Auditor has broad powers to "audit" or "investigate" a variety of executive and other branches of government. Suggestions as to Legislative fixes may be appropriate. In that regard, however, the decision to spend two and a half years and countless auditors and investigators on the only executive agency run by an elected Republican and ignore the prominent, public and private reports of the "pay-to-play", bribery and kickback culture of the Auditor's own political party deserves scrutiny as well. The decision not to investigate prominent persons who have contributed directly to the Auditor's campaign and to various Democratic candidates and campaigns while the donee's firm does significant business with the State Auditor's office and many other agencies should be considered as well.

The decision to focus on the only agency that has not increased government employees or bloated a budget at taxpayer expense means, necessarily, that other public disclosures of kickbacks, bribes, "pay-to-play" schemes and payments to politically prominent "third party agents" in the State Auditors own party, escape attention.