



Audit of Land Lease Compliance

Project #12-16

Prepared by
Office of the Inspector General

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SOUTH FLORIDA WATER MANAGEMENT DISTRICT

December 13, 2012

Audit and Finance Committee Members:

Mr. Timothy Sargent, Chair
Mr. Glenn J. Waldman, Vice Chair
Mr. James J. Moran, Member
Mr. Juan M. Portuondo, Member

Re: Audit of Land Leases
Compliance
Project No. 12-16

This audit was performed pursuant to the Inspector General's authority set forth in Chapter 20.055, F.S. Our objectives primarily focused on assessing the effectiveness of the monitoring process in ensuring that lessees adhere to lease provisions. Dan Sooker and I prepared this report.

Sincerely,

A handwritten signature in blue ink that reads "J. Timothy Beirnes".

J. Timothy Beirnes, CPA
Inspector General

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BACKGROUND

In accordance with the 2012 Audit Plan, we conducted an Audit of Lease Compliance. District properties that have been purchased for stormwater treatment areas, surface water reservoirs, and other water resource projects are sometimes leased for the interim period between the acquisition of property and the start of the project for which the land was acquired. Leases are an important source of revenue for the District.

The District has 97 lease agreements that generally require lessees to take on most of the management responsibilities for these lands. Lease holders temporarily keep public lands in production, pay taxes and local assessments. Upon execution of the lease, the property is placed on the tax rolls of the county, in which the property is located. The lessee agrees to pay all real property taxes, intangible property taxes and personal property taxes, as well as all assessments. Lessees are also responsible for maintaining the land in good condition, which often times includes implementing best management practices (BMP). For example, a grazing lease BMP may limit the number of heads of cattle per acre or require the lessee to control exotic vegetation. The District monitors the lease agreements to ensure lessee compliance with these requirements.

The District's Land Management Section is responsible for overseeing the leasing operation. Land Management staff devotes a significant amount of time and resources conducting compliance inspections of District leases. The Section is situated in the Land Resources Bureau and consists of 22 employees located throughout the District to oversee and monitor District owned property, including lease compliance. Most of the staff work from service centers and other remote locations that are closer to the leased property.

This Section was first known as the Interim Land Management Division when it was established in 1998 to manage District-owned CERP and project lands in the interim period between acquisition and project construction, which provided a positive economic impact to local communities by developing leasing opportunities that create jobs and support local businesses. The Division was initially staffed with six employees who were responsible for managing 12,200 acres of land and 25 lease contracts, which generated approximately \$675,000 in revenue annually.

By 2005, the amount of land made available for leasing had increased substantially. To handle the increased workload, the Interim Land Management Division's property inspection and business staff functions were combined into the Land Stewardship Division. The program at that time consisted of nine staff members who managed 71 leases on more than 90,000 acres of land. These leases generated funds in excess of \$3.7 million annually. In 2006, the program grew to include 100 leases on 131,000 acres of land, which generated approximately \$4.8 million in annual revenue.

As noted in the adjacent table, revenue generated from leased properties totaling 128,203 acres was approximately \$4.3 million in fiscal year 2012.

Sugar cane leases primarily relate to Florida Crystal and US Sugar leases. Florida Crystal leases expire

Lease Type	# of Leases	Acres	Annual Lease Payments	Revenue per Acre
Sugar Cane	8	25,815	\$2,625,147	\$102
Cattle Grazing	54	72,393	671,216	9
Citrus Operations	8	23,323	143,427	6
Communication Tower	3	112	308,037	2,750
Equestrian Operation	1	85	121,196	1,425
Row Crops	3	1,195	222,936	185
Mining	1	202	125,000	619
Other	19	5,078	68,966	14
Total	97	128,203	\$4,285,925	\$33

2013 through 2016 and US Sugar leases expire in 2021. Annual lease revenue from Florida Crystals and US Sugar leases is approximately \$1.2 million and \$1.3 million, respectively. The most common lease types are cattle grazing and citrus operations but these leases produce the lowest revenue per acre. However, these leases provide other tangible benefits such as exotic vegetation control and security. The communication tower annual lease payments of \$308,037 are derived from 3 leases of which \$260,150 is from a lease with Raycom National, Inc. As described more fully on page 11, the mining lease payment of \$125,000 represents a prepayment for future mining of District property. Mining of District property is expected to commence in 2014, at which time the District will receive quarterly royalty payments from the lessee for aggregate tonnage mined.

The Land Management Section has recently developed a coordinated process to evaluate new leasing opportunities. Staff from various disciplines evaluate and assess the leasing suitability of all District properties. The Section is working on other program enhancements to increase leasing revenue and improve accountability.

OBJECTIVE, SCOPE AND METHODOLOGY

The objective of our audit was to assess the effectiveness of the monitoring process in ensuring that lessees adhere to lease provisions. In order to accomplish our objectives, we performed the following:

- Documented District lease monitoring process.
- Selected a sample of leases to ensure lessee compliance with agreement provisions.
- Visited and inspected leased properties.
- Performed a detailed review of the District's mining lease agreement with White Rock Quarries.

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

AUDIT RESULTS

Executive Summary

We found the District's land management professionals were competent and very dedicated to protecting District lands. Recently, the Land Management Section revised inspection procedures to more closely align the inspection report with lease compliance requirements. Our review of these procedures indicated a more thorough inspection report and improved follow-up for non-compliance issues.

Our inspection of 12 leased properties that are located throughout the District indicated no instances of non-compliance with lease terms. However, while on these site inspections, we found that certain cattle grazing properties were very difficult to access which may result in less interest from potential bidders other than the adjacent landowners. Accordingly, the only interested lessee of the property may be an adjacent landowner.

Our review of the exotic plant control provision of District lease agreements indicated differing levels of lessee responsibility for exotic plant management. In addition, for leases that required the lessee to control new exotic vegetation growth, we found that there was no baseline established for existing growth at the time of lease execution. Going forward, we recommend that the District establish a consistent methodology for lessee's exotic plant management and develop a baseline for existing growth at lease inception.

The District leases property in the Lake Belt area of Miami-Dade County to White Rock Quarries (WRQ) and receives an annual prepaid royalty payment of \$125,000, which will offset royalty income after White Rock Quarries (WRQ) mining operation commence in 2014. The Board of Trustees of the Internal Improvement Fund of the State of Florida (TIIFT), and WRO also own parcels that are intermingled in the Lake Belt mining area.

The District's royalty income will be based on aggregate tonnage mined multiplied by \$0.95 (adjusted for the producer price index) and the ownership percentage allocation which is determined by the acre owned in the mining area. According to the lease agreement with WRQ, the District's ownership percentage of 25.4% is based on total leased acreage of 192 acres. However, Exhibit D of the amended agreement indicates the number of acres owned by the District is 202 acres; while Exhibit D of the original agreement disclosed 177.02 acres. We

recommend that the District determine the correct number of acres that should be used to calculate its royalty income.

We also found that the lease agreement includes a provision for WRQ to engage an independent engineering firm (with prior experience in lime rock mining) to certify the net tonnage extracted during the year. Upon completion of mining operations, the results of each annual survey and report is subject to final review and verification by the District and other interested parties. We recommend that rather than waiting for completion of mining operations, the District, proactively consider jointly selecting and engaging an independent engineering firm with WRQ or engaging a firm independent of WRQ to verify the annual calculation of lime rock yielded.

Lessee Access to District Land May be Difficult for Other Potential Tenants

We found that District land management professionals who monitor interim leased and vacant lands are competent and very dedicated to protecting the District's lands. These professionals conduct semi-annual inspections on all interim leased and vacant lands to provide a formal record of lease compliance. To document inspections the land managers complete a semi-annual inspection report, which in our opinion was deficient in documenting the lessee compliance with lease terms and conditions. Recently, the Land Management Section developed a more robust inspection process that more closely aligns the inspection report with lease requirements. The new documentation requirements are considerably more detailed. In addition, the inspection report will be on a District website for the public to view. The lease contract, land location, lease terms and other information related to the lease will also be available online. This transparent process will result in an enhanced on-the-ground lease compliance inspection program and reporting database and an overall improvement in accountability.

We selected 12 of the 97 leases that are located throughout the District to conduct site visits and to confirm compliance with lease terms. The site visits consisted of seven cattle leases, one citrus operation lease, one row crop lease, one communication tower lease, one mining operation lease and one equestrian facility lease. We were accompanied by Land Resources Section leaders and land managers assigned to the geographic area. We noted no instances in which lessees were not in compliance with lease agreement terms and conditions.

Our site visit to seven cattle grazing lease properties indicated that in six of the leases the pasture land appeared in good condition except for one of the grazing leases, in which the pasture land, located in St. Lucie County, appeared in poor condition. As the adjacent picture illustrates, this property was an active citrus grove when the District purchased it in 2002. Subsequently, the trees were removed and the property was leased



Grasses appear excessively high and of poor quality

for grazing. The condition of the pasture land was not the fault of the lessee but a result of its previous use. In its current condition, this land does not appear well-suited for grazing. The District receives \$14.86 per acre for this cattle grazing lease which is \$2.74 below the average annual lease revenue for cattle grazing leases in St. Lucie County. If pasture land improvements on this property would further increase lease revenue, the District should consider enhancing the pasture through lease credits to the lessee for improvements made.

Conversely, the picture to the right represents good pasture land that has a high content of Bahia grass and is generally 6 inches high.



Example of Bahia grass pasture

Our review of the exotic plant control provision of the District lease agreements indicated differing levels of lessee responsibility for exotic plant management. Some leases required the lessee to eradicate only new exotic growth, other leases allowed only mechanical eradication methods, while others allowed herbicide application with District preapproval. In addition, for leases that required the lessee to control new exotic vegetation growth, we found that there was no documentation establishing a baseline for existing growth at the time of lease execution. These variations add to the difficulties in monitoring and enforcing the exotic vegetation control provision of the lease agreements. Going forward, we recommend that the District establish a consistent methodology for lessee's exotic plant management.

We also found that a certain leased cattle grazing property was very difficult to access. Currently, this is not a problem for the lessee because he owns land next to the leased land. This lease expires in 2015 and the District will probably re-lease the property through a competitive process. However, lease interest from potential bidders other than the adjacent landowners may be limited because of the access restraints. As a result, the only viable lessee of the property may be an adjacent landowner.

Recommendations

1. **Establish a consistent methodology for lessee's control of exotic vegetation and a baseline for existing growth at lease inception.**

Management Response: Management agrees with the recommendation. Staff has been actively modifying the exotic plant control lease language over the past several years as new leases are issued or when existing leases are extended in order to provide the recommended lease language uniformity. The language is being modified to remove mandated exotic plant control activities in order to maximize lease revenue, assure District compliance with Federal and State reporting requirements, and in recognition of the difficulty and expense in establishing a quantitative and defensible baseline for documenting pre-lease existing exotic plant infestations and exotic plant control lease compliance. The amended language has been primarily focused on herbicide applications but will also incorporate exotic plant control by mechanical means.

Responsible Division: Operations, Maintenance, and Construction

Estimated Completion: On-going. In order to avoid the additional staffing and salary expense associated with executing lease amendments, the exotic plant control language modification will continue to be incorporated into new leases as part of the normal lease development process.

2. Consider conducting pastureland improvements, where needed, through lease credit to lessees for enhancements made.

Management Response: Some of the District's interim project lands are former croplands (e.g., citrus, sugarcane, vegetables) and typically do not have the optimal forage grass species needed on-site should land managers decide to convert the land or lease use to cattle grazing. These lower-quality grazing lands are appraised at a lower market rent than those properties that contain optimal grazing biomass. When the former cropland properties are advertised for a cattle grazing lease, the results are a lower minimum bid price.

The Leasing & Mitigation Administration Unit currently has a process or mechanism in place to provide credits to new lessees that are required to erect fencing around the perimeter of their cattle grazing leases. Therefore, it is possible to consider lease credits for pastureland improvements and enhancements.

District management must consider the costs of offering rent credits for fencing and pastureland improvements against the anticipated revenue generated for the lease and cost of land management activities should the property remain vacant. Agricultural lease terms are held at a maximum of ten years. Depending on the size of the property and the linear feet of fencing needed, the District may not see a positive revenue generation from the lease until the last couple of years of the lease term. If the District were to add the extra expense of pastureland improvement credits to the existing fencing credits, then there is the possibility of not generating any lease revenue at all.

In addition, management must also consider the long-term land management goals for these former cropland properties. If the land will eventually be used for a construction project where the soils will be significantly disturbed, then foraging improvements may be a viable option to increase the interim value of the land for grazing. However, many of the District's grazing leases occur on lands acquired for conservation and restoration purposes. Prescribed grazing is used on these areas as a land management tool to manage native vegetation and reduce some exotic plant species. Planting exotic grasses on these areas to support increased cattle stocking rates would be

contrary to the overall management strategy for these lands and would increase the exotic plant control costs associated with planned restoration activities.

The project's construction schedule should be considered as well. If the project will start within the ten-year lease term, then money may be owed to the lessee for their fence and forage improvements. If the project schedule indicates that construction commencement is ten to twenty years away, then the District should be able to generate more income on the second lease when the pastureland improvements are fully realized and the costs recuperated.

As requested, the Leasing & Mitigation Administration Unit, in coordination with the Land Management Unit, will perform a cost/benefit analysis of offering lease credits for both fencing and pastureland improvements/ enhancements to cattle grazing lessees on properties with less than optimal foraging material with consideration of the long-term land management goals.

Responsible Division: Operations, Maintenance, and Construction

Estimated Completion: December 2012

District Ownership Acreage In a Rock Mine Lease May be Understated

The District owns land adjacent to a lime rock mining operation in the Lake Belt area of Miami-Dade County that it has been leased to White Rock Quarries (WRQ) to allow the company to mine, quarry and manufacture lime rock on District land. According to Exhibit D of the lease agreement dated April 12, 2006, District parcels consist of 177.02 acres. The District purchased the majority of this land on December 20, 1996, for \$2,350,000. The Board of Trustees of the Internal Improvement Fund of the State of Florida (TIIFT) and WRQ also own parcels in the Lake Belt area that are situated adjacent to District parcels and will also be mined.

The company agreed to pay the District, a prepaid royalty of \$75,000 annually for the initial three year term and \$125,000, thereafter until the mining operations on District land

commenced. All WRQ prepaid royalty payments are creditable against royalty production payments due when mining operations of the property begins.



An aerial view of District, TIIFT and WRQ parcels that will be mined in 2014.

Our site visit indicated that District property is currently undisturbed and the company projects that mining operations on District lands will begin in approximately 2014. It is important to note that WRQ agreed to convey its parcels to the District after mining operations are completed.

According to the original agreement, WRQ was going to pay the

District \$0.95 per short ton, multiplied by the scale weight of lime rock sold from its parcels when mining operations commenced. The royalty rate of \$0.95 is adjusted if the Producer Price Index (PPI), published by the U.S. Department of Labor, Bureau of Labor Statistics changes from the "Base Period Index". The Base Period Index is the PPI in effect for the month of March, 2006¹.

Under this valuation methodology determining the amount of lime rock sold that originated from District parcels would have been unnecessarily complex. Accordingly, through a subsequent amendment, this quarterly royalty payment calculation was revised to pay royalties to the District and each of the other parcel owners based on aggregate tonnage mined multiplied by \$0.95 (adjusted for the producer price index) and the ownership percentage allocation. The ownership percentage allocation of District, TIIFT and WRQ was 25.4%, 57.27% and 17.33%, respectively.

The amended lease agreement indicates that the District's ownership percentage of 25.4% is based on parcels totally 192 acre. However, Exhibit D of the same amended agreement

¹ The producer price index fluctuates monthly, however, as of June 2012; the index for construction, sand and gravel mining has increased 27% over the base period index. We expect the index to continue to fluctuate.

indicates the number of acres is 202 acres; while Exhibit D of the original agreement disclosed 172.09 acres. We recommend that the District determine the correct acreage that should be used to calculate its royalty income.



WRQ mining operation

We also found that the agreement includes a provision for WRQ to engage an independent engineering firm (with prior experience in lime rock mining) to certify the net tonnage extracted during the year. Upon completion of mining operations, the results of each annual survey and report is subject to final review and verification by the District and other interested parties.

Rather than waiting for completion of mining operations, we recommend that the District, consider jointly selecting and engaging an independent engineering firm with WRQ or engaging a firm independent of WRQ to verify on an annual basis the calculation of lime rock yielded.

Recommendations

- 3. Determine the correct acreage that should be used to calculate District royalty income.**

Management Response: Staff agrees that the land acquisition documents and the lease contract for White Rock have conflicting numbers for the exact amount of acreage owned by the District. The Leasing & Mitigation Administration Unit will work directly with the Real Estate Unit to conduct a thorough review of the closing documents in order to determine the correct acreage figure to be used in the lease. The results will be reported to the IG's Office and corrected in the lease contract.

Responsible Division: Operations, Maintenance, and Construction

Estimated Completion: December 2012

- 4. Consider jointly selecting and engaging an independent engineering firm with WRQ or engaging a firm independent of WRQ to verify the annual calculation of lime rock yielded.**

Management Response: Staff in the Land Leasing & Mitigation Administration Unit, in coordination with the Office of Everglades Policy, will meet with the lessee (White Rock) representatives and discuss the possibility of amending and modifying the lease documents to contract with an independent entity to verify the annual amount of lime rock extracted from the leased property.

Responsible Division: Operations, Maintenance, and Construction

Estimated Completion: December 2012