

The General Land Office's Leases of State-Owned Lands

The General Land Office's Table of Contents

Summary	23
Section 1: Four of the General Land Office's Seven Types of Surface Leases Did Not Recover Their Costs, With One Lease Type Not Recovering Approximately \$1 Million	25
Section 2: Estimated Value and Appraisals of Coastal Cabins.....	27
Section 3: Issuance of Cabin Permits and Other Leases Could Be Enhanced to Further Protect the State's Interests	28
Section 4: Comparison With Other States' Lease Programs	29
State Auditor's Recommendations	32
The General Land Office's Response	33

Summary

The General Land Office (Office) is not recovering the full cost of administering four of its seven surface lease types, with one lease type not recovering approximately \$1 million in fiscal years 1998 and 1999. However, in total, these leases collect more revenue than it costs to administer them.

- Coastal easements earned less than 15 percent of the costs incurred to manage the leases, with costs not recovered of approximately \$1 million in fiscal year 1998 and again in 1999.
- Coastal leases earned less than 2 percent of the expenditures incurred to manage the leases, with costs not recovered of approximately \$81,000 in fiscal year 1999 and \$74,000 in fiscal year 1998.
- Coastal surface lease revenue was just over half of the costs incurred to administer the leases. The coastal surface leases did not recover approximately \$37,000 in fiscal year 1999 and \$33,000 in fiscal year 1998.
- Coastal cabin permit revenue was just over half of the costs incurred for administration. The cabin permits did not recover approximately \$114,000 in fiscal year 1999 and \$97,000 in fiscal year 1998.

Table 1

Lease (Assignment) Type	Fiscal Year 1999		Contribution/ (Deficit)
	Revenues	Expenditures	
Coastal Easements	\$ 169,097	\$ 1,236,920	\$ (1,067,823)
Coastal Leases	1,645	82,828	(81,183)
Commercial Leases and Easements	1,025,311	221,471	803,840
Surface Leases – Uplands	876,321	321,533	554,788
Surface Leases – Coastal	43,517	80,095	(36,578)
Cabin Permits	198,624	312,604	(113,980)
Miscellaneous Easements	819,913	679,631	140,282
Total	\$ 3,134,428	\$ 2,935,082	\$ 199,346

Source: The State Auditor's Office developed estimates and applied them based on the division staff estimates.

In addition, the estimated value of the Office's coastal cabin permits appears to exceed the income realized by the State for these leases. The Office issues permits for cabins along the Texas coast that are built and maintained by the permit holders.

It assesses an annual rent of \$0.60 per habitable square foot. The estimated value is \$18 per square foot, based on a depreciated replacement cost analysis performed by an independent appraiser. Permits are sometimes sold privately if the Office approves a transfer of the permit from one individual to another. The estimated value of such sales for cabin permits varies considerably with location and amenities. Permits in less desirable fishing areas can be valued at \$20,000 to \$30,000. Permits in highly desirable areas can be valued at or above \$50,000.

The commercial leases and easements, upland surface leases, and miscellaneous easements earned more than they cost to administer. The majority of the revenue collected from leases goes to the Texas Education Agency's Available School Fund and the Permanent School Fund. The costs to administer the leases are paid from the Office's General Revenue Fund appropriations.

When the State Auditor's Office requested the cost information, the General Land Office did not have a method to capture actual cost information by type of lease. In addition, the General Land Office has not assessed its costs by lease type to determine whether costs could be reduced or whether the fee structure is reasonable. The General Land Office cannot accurately determine the amount of resources it expends on administering each lease type because it does not have a sound cost allocation method.

The State Auditor's Office did not review leases related to oil and gas or minerals, nor did we audit the financial systems that produced the numbers used in this report. This study focused on financial aspects of the surface leases of state-owned land, not on assessing economic impact or environmental concerns.

Four of the General Land Office's Seven Types of Surface Leases Did Not Recover Their Costs, With One Lease Type Not Recovering Approximately \$1 Million

Information
provided by the
State Auditor's
Office

The General Land Office (Office) is not taking advantage of the revenue-generating potential of certain programs. The Office is not recovering the costs of administering four of its seven surface lease types, with one lease type not recovering approximately \$1 million of its costs. Not only is the Office not recovering its costs to administer these four lease types, but the State is also not maximizing its revenue opportunities for the use of state-owned land. However, in total these leases collect more revenue than it costs to administer them.

The commercial leases and easements, upland surface leases, and miscellaneous easements earn more than they cost to administer. The majority of the revenue collected from leases goes to the Texas Education Agency's Available School Fund and the Permanent School Fund. The costs to administer the leases are paid from the Office's General Revenue Fund appropriations.

The four lease types that did not recover their costs are coastal easements, coastal leases, coastal surface leases, and cabin permits. Specific details on the costs not recovered for the four lease types during fiscal years 1998 and 1999 are as follows:

- The coastal easement leases earned less than 15 percent of the costs incurred to manage the leases, with costs not recovered of approximately \$1 million in each of the fiscal years 1998 and 1999.
- The coastal leases earned less than 2 percent of the expenditures incurred to manage the leases, with costs not recovered of approximately \$81,000 in fiscal year 1999 and \$74,000 in fiscal year 1998.
- The cabin permits earned \$0.64 for every dollar spent to administer them, with costs not recovered of approximately \$114,000 in fiscal year 1999 and \$97,000 in fiscal year 1998
- The coastal surface lease revenue was just over half of the costs incurred to administer the leases, with costs not recovered of approximately \$37,000 in fiscal year 1999 and \$33,000 in fiscal year 1998.

The effect for the State is that General Revenue appropriations paid at least \$1 million more in fiscal years 1998 and 1999 for these lease activities than the Available and Permanent School Funds received in revenues. (See Appendix 8 for a complete table of fiscal year 1998 revenues and costs.)

Table 2

Fiscal Year 1999			
Lease (Assignment) Type	Revenues	Expenditures	Contribution/(Deficit)
Coastal Easements	\$ 169,097	\$ 1,236,920	\$ (1,067,823)
Coastal Leases	1,645	82,828	(81,183)
Commercial Leases and Easements	1,025,311	221,471	803,840
Surface Leases – Uplands	876,321	321,533	554,788
Surface Leases – Coastal	43,517	80,095	(36,578)
Cabin Permits	198,624	312,604	(113,980)
Miscellaneous Easements	819,913	679,631	140,282
Subtotal	3,134,428	2,935,082	199,346
Mental Health and Mental Retardation ^a	290,159	158,779	131,380
Other State Agencies ^a	98,142	13,333	84,809
Total	\$ 3,522,729	\$ 3,107,194	\$ 415,535

^a The Office assists other agencies that have state-owned land with their leases. The Office's involvement in the leasing process varies, depending on the need of the agency. The Office does not usually receive any compensation for costs it incurs. The Office will sometimes receive reimbursement for some of its costs through a clause in the lease agreement or through a memorandum of understanding with the other agency. The expenditures are for the Office's costs associated with assisting the other agencies with leases. However, the revenues are deposits to other agencies.

Note: The table shows total revenues and expenditures for each of the seven lease types reviewed, with the resulting contribution/deficit. In addition, system developmental costs of \$71,125 have been deducted from the expenditures because the grant revenue for the system was realized in a prior year.

Source: The State Auditor's Office developed estimates and applied them based on the division staff estimates.

The Office has not reviewed the financial status of these leases by individual lease type for 1998 or 1999 to determine if it could possibly reduce costs or whether the fee structures are reasonable. According to the Office, its primary focus has been to preserve the State's resources; therefore, the Office reviews costs by function rather than by individual lease type. The Office cannot accurately determine the amount of resources it spends on administering the individual lease types because it does not have a sound cost allocation method. The Office does not have a method for determining actual costs for each lease type because:

- The Office does not adequately track time spent administering various lease types or have a sound basis for the estimated percentages of time spent on the individual lease types. (The costs provided in Table 2 above are allocated using a percentage based on the divisions' estimates.)
- The Office recognizes fees and rent (revenues) from leases when they are received, not when they are earned. For example, a leaseholder may pay his or her lease rent three years in advance. The Office does not allocate the rent over the three years, but in the fiscal year that it is collected. However, the costs are recorded in each fiscal year. While this is correct governmental accounting for the financial statements, it does not provide a true picture for analyzing cost recovery and fee structure.

As a result, there is no accurate way to determine the actual costs by individual lease type associated with administering the various leases. The estimated numbers in this report are based on information from division staff members who estimated the percentage of time spent administering each lease type.

Estimated Value and Appraisals of Coastal Cabins

Information
provided by the
Comptroller of
Public Accounts

The Office renews permits for 435 existing coastal cabins. No permits are issued for new cabin locations and structures. This increases the value of the current permits, which can be and are passed down through generations and privately bought and sold. The land and cabin structures are owned by the State but built and maintained by permit holders. The permit only gives the individual the right to inhabit the cabin. The Office assesses an annual rent of \$0.60 per habitable square foot. The average rental payment to the Office for a cabin permit is \$628 annually. The estimated value of the cabin structures is \$18 per square foot, based on a depreciated replacement cost analysis performed by an independent appraiser.

The real value for the State relates to the permit itself rather than the cabin structures because the number of permits is limited. However, it is not possible to assess a value for the permit because the permits are sold in private transactions. The permit holder must get approval from the Office to transfer his permit to another individual and pay a transfer fee, but the value of the transferring permit is not disclosed to the Office. Therefore, to make some assessment of the relative value of the cabin lease permits compared to the revenue received, the cabin structures were appraised. This approach seemed reasonable because the revenue collected is based on the habitable square footage of the structures. However, interviews and discussions with local Office staff members, local residents, and local chief appraisers indicate that the sale value of a permit in a private transaction could range from \$7,000 for a poor cabin in a relatively inaccessible location to \$80,000 and up for premium cabins in popular fishing areas.¹ Sizes of the cabins vary from 284 square feet to over 6,000 square feet.

Half of all current cabin permits are issued for cabins along the intracoastal and bay waters of Kenedy and Kleberg counties. The remainder are issued for cabins along the waters of Brazoria, Jackson, Calhoun, Aransas, Refugio, San Patricio, Nueces, Willacy, and Cameron counties.

¹ Interviews with General Land Office Coastal Coordination Council permitting assistance coordinator in Corpus Christi, Texas, field office (since retired), November 2000; also, Willacy County Navigation District staff, November 2000.

Issuance of Cabin Permits and Other Leases Could Be Enhanced to Further Protect the State's Interests

Information
provided by the
State Auditor's
Office

Overall, the Office's agreements for the cabin permits and other leases appear to contain the basic terms and conditions needed to protect the interests of the State. The agreements might be strengthened with additional clauses that were found in similar lease agreements used by other state agencies. For example, the leases and permits could possibly be strengthened with clauses that allow the Office to adjust the rent or fees during the term of each lease.

As in the case of the Parks and Wildlife Department's oyster-bed leases, the Office does not use a competitive process to issue the cabin permits. Cabin permits are issued for five-year terms. At the end of the term, the leaseholder simply renews the permit for another five-year term after an inspection by the Office. In addition, leaseholders may transfer permits to someone else. The leaseholder must notify the Office of any permit transfer, which the Office must approve. The Office charges a \$325 transfer fee, but the State realizes nothing if the permit holder engages in a private sale of the transferred permit.

Some cabin permits issued by the Office may be in violation of the Texas Natural Resources Code, Sections 33.124 and 33.125, and Texas Administrative Code, Title 31, Section 155.4. Both codes state that the School Land Board may not grant a permit authorizing continued use of a structure located within 1,000 feet of a state or federal wildlife sanctuary or refuge. In 1991, the Brazoria National Wildlife Refuge boundaries were expanded. Some existing cabin structures were located in the expanded boundaries. There are approximately 66 cabins that may be in violation of this law. According to the Office, it has terminated 14 of these permits within the past year and is working to terminate the remainder.

Comparison With Other States' Lease Programs

Information
provided by the
Comptroller of
Public Accounts

The federal Submerged Lands Act of 1953 granted states the rights to natural resources of the submerged lands from the coastline to no more than 3 nautical miles (5.6 km) into the Atlantic, Pacific, the Arctic Oceans, and the Gulf of Mexico. A major exception is the coastal waters of Texas and western Florida, where state jurisdiction extends from the coastline to no more than 3 marine leagues (16.2 km) into the Gulf of Mexico.²

As with Texas, the most common forms of coastal leases in the states surveyed for this report are issued for mineral exploration and production, commercial purposes, and docks and piers. For the purposes of this report, we surveyed the residential and recreational lease, permit, or license programs of several Atlantic, Pacific, and Gulf Coast states.

Alaska

The State of Alaska has a Personal Use Cabin Permit Program, developed specifically as a one-time solution to the large number of unauthorized cabin structures on state land. (Most cabins were used for duck hunting and sheltering winter snow machines.) The program was intended to phase out the cabins. It was based on a lifetime estate or permit granted to those names on the original application. When all of the owners of a particular cabin are deceased, the cabin is either removed or can be converted to a public use cabin. The permits are for the foot print of the cabin and do not include any land acreage. The permits are renewed every six years at a cost of \$100 annually. The original cabins may not be improved or replaced in the event of a loss. The permit is not assignable.

When the state began this program, and moved to identify and permit unauthorized cabins (which Alaskans call "duck shacks"), it discovered many new unauthorized cabins whose owners would also like to be rewarded with a cabin permit.

Alaska has other 10-year non-renewable leases available for commercial purposes, for a \$100 non-refundable application fee, public notice costs and survey and appraisal costs if necessary. These leases may be renewed after a new public review process, but the procedure is not automatic. The annual lease fee varies from regulation to regulation for different programs. Some commercial guide camp leases rent for \$2,000 per year based on fair market value. Other 10-year lease rentals also based on fair market value are computed at a per acre basis ranging from \$250 to \$1,500 an acre.

Leases issued by the State of Alaska can be assigned provided the leaseholder is in good standing, the site is used according to the development plan and the rent is paid. Damaged or destroyed structures under this program can be replaced.

² U.S. Minerals Management Service, Federal Offshore Statistics through 1998 (Washington, D.C., 1999), p. 1. (Internet document.) www.mms.gov/stats/PDFs/Fedlands.pdf

Florida

The Florida Department of Environmental Protection acquires and disposes of lands as directed by the Board of Trustees of the Internal Improvement Trust Fund. The Department oversees approximately 11 million acres of state lands, including more than 7,000 lakes and 4,510 islands of 10 acres or more in size. The department provides upland leases for educational facilities, vegetable farming, and mineral, oil, and gas exploration.

Florida has a program similar to the Office's cabin leases, but on a much smaller scale. The Florida Department of Environmental Protection's Submerged Land section monitors 20 "stilt houses" in state waters on Florida's western coast in Pasco, Charlotte, and Lee counties. The houses are privately owned.

In the 1970s, the state required owners of these houses to register with the state. In the 1980s, the state told all registered owners they would have to pay a fee for being on state land beginning in 1998. At that point, no more stilt houses could be built. These owners paid \$200 for the 20-year lease with the state that requires annual rental adjustments every five years. Leases are renewable, are not competitively bid and do allow for rebuilding. The current annual lease rate is \$841 dollars. The next adjustment will be in 2002.

Louisiana

The Louisiana Department of Natural Resources provides staff support to the State Mineral Board in granting and administering leases on state-owned lands and water bottoms. Leases issued are exclusively for the production and development of minerals, primarily oil and gas, and for the purpose of optimizing revenue to the state from the royalties, bonuses, and rentals generated therefrom.

No evidence could be found that the state has a program similar to the Texas cabin lease program.

Maine

Maine's Bureau of Parks Land grants standard leases and constructive easements on the submerged lands along the state's rocky Atlantic Coast. Standard leases are issued for all structures that in total area occupy more than 500 square feet and are limited to commercial fishing use. The minimum annual rental fee is \$100.

For both permanent and non-permanent structures occupying less than 500 square feet, the state may grant a 30-year lease or easement, to be renewed at the Bureau's option. Leases are transferable with the Bureau's prior written approval.

All structures on submerged lands existing before October 1, 1975, were granted constructive easements; however, all easements are due to terminate by September 30, 2005.

For the easements, Maine charges a \$50 application processing fee and a five-year \$50 registration fee payable when the lease is executed and every five years thereafter. Any lease transfers, assignments, and amendments have a \$10 administrative processing fee.

The non-commercial easements are usually for private berthing and docking spaces. Leaseholders are prohibited from renting these facilities out or charging a fee for their use.

State Auditor's Recommendations

1. The Office should immediately begin capturing cost information by individual lease type. Management should develop a sound cost allocation method. The methodology and basis used should be documented. With a sound cost allocation method in place, management can determine whether costs can be reduced. Analyzing costs by individual lease type in conjunction with current practice would provide a complete picture for making management decisions.
2. Management should determine whether the fee structure for leases is reasonable based on the results of program cost analysis. Management should make the necessary recommendations to the School Land Board for any fee increases. Management and the School Land Board should take into consideration the commercial value of the permits and leases when setting the fees.
3. The Office should determine whether the State and its citizens would be best served by continuing each cabin permit and make a recommendation to the School Land Board. If not, structures should be removed from the property at the earliest possible time.
4. The School Land Board should review its current rules regarding damage and removal of structures. The Office should determine the best method to recover the State's costs for removing the structures and remediating environmental damage if the permit holder fails to satisfy its contractual obligation. These methods may include requiring a bond or non-refundable deposit from leaseholders, or increasing damage fees.
5. The Office should determine which surface lease types, if any, would best benefit the State by issuance through a competitive process. At the end of lease terms, the Office should renew leases using a competitive process to ensure that the State receives maximum benefit for the use of state-owned resources. The Office may want to follow its competitive bidding procedures for oil and gas lease sales.
6. Permits and lease agreements could possibly be strengthened with additional clauses wherever applicable that would increase benefits to the State.
7. Cabin permits still in violation of state laws should be terminated as soon as possible.

The General Land Office's Response

Texas General
Land Office



David Dewhurst
Commissioner

December 5, 2000

Mr. Lawrence F. Alwin, CPA
P.O. 12067
Austin, Texas 78711-2067

Dear Mr. Alwin:

Management of the General Land Office (Office) generally agrees with the report's conclusion that some of the surface lease types did not fully recover their administrative costs, but that overall the net of revenues over costs for the surface lease program exceeded \$415,000 during the review period. As the auditors stated, there is no statutory requirement for the surface lease program to recover its costs; however, the program did so. One of the primary responsibilities of the surface lease program is to preserve coastal public land, which does not necessarily imply revenue maximization. The Office has charged fees that are relevant to the type of lease instrument issued. As such, lease types with a coastal protection or regulatory purpose do not necessarily result in revenues commensurate with those resulting from commercial lease instruments, even though the costs of administering the leases may be comparable.

The Office would like to emphasize that revenues generated from surface leases other than cabin permits are not used for program operations but instead are deposited directly into the State Treasury, primarily into the Permanent School Fund and the Available School Fund. On the other hand, program operations are funded from appropriations the Office receives from the Legislature.

The Office disagrees with the report's comparison between the \$.60 per square foot annual rental fee charged for cabins and the \$18 per square foot estimated depreciated replacement value of the structures, which the permit holders actually built and paid for. As the report indicates, some permit holders may be receiving compensation from new permit holders when they have their permits transferred to them. The compensation would represent a value in the permit itself, which the Office does not currently receive any part of.

Sincerely,

A handwritten signature in black ink, appearing to read "Larry R. Soward".

Larry R. Soward
Deputy Land Commissioner/Chief Clerk

LRS: HSY

Stephen F. Austin Building

1700 North
Congress Avenue

Austin, Texas
78701-1495

512-463-5001

1. *The Office agrees with the importance of capturing accurate cost information and will continue to capture such data along the major functional lines of accountability for the lease program, as it has been doing. Costs will also be directly attributed to the instrument types where feasible or allocated on the basis of the proportional effort involved, such as the number of inspections performed.*

The Office has taken actions to reduce costs associated with the lease program through the years. One example of actions taken to reduce costs that resulted from internal cost analysis involved a re-organization and staff reduction in 1999 that resulted in approximately 12 full-time positions being eliminated or left unfilled. Another example is the proposed rule changes that the Office will present to the School Land Board (SLB) at the January 2001 meeting which will streamline lease operations, thereby further reducing program costs.

2. *The Office agrees with the benefit of assessing the reasonableness of the fee structures for surface leases. Staff consideration has been given to whether changes are warranted and should be recommended to the SLB, which holds the ultimate authority for establishing the fee structure for surface leases. Fee increases for surface leases were last made effective in 1996 and have continued to be evaluated. It should be noted that the amount of fees charged for the various surface lease instruments is not based solely on the costs associated with administering the lease instruments. Also, the statutory provisions that authorize surface leases do not mandate cost recovery.*

The surface lease fee structures take into consideration the type of activity being licensed, including whether the instrument is for public recreational use, such as public piers and public park boat ramps; for private use, such as residential piers; or for commercial uses, such as for marinas or restaurants. The fee structures also consider any benefits provided to the State and its land, such as habitat restoration and protection projects contributed by lessees under leases for which a token amount of fees is collected. Also, the fees for coastal surface leases take into account that many of the leases are issued to oil and gas companies to encourage offshore oil and gas drilling, from which the Permanent School Fund receives very sizeable royalties that were not included in the revenues presented in this study.

3. *The Office agrees that dilapidated or derelict cabin structures should be removed at the earliest practicable time. The Office has, and will continue to use, a process in which staff analyzes every cabin permit application or transfer request and makes recommendations to the SLB. The SLB makes the final determination of whether the permit is in the best interest of the State and the public. Every cabin permit has been, and will continue to be, reviewed individually to ensure compliance, consistency and fairness.*

4. *The Office is currently addressing the concern about removing damaged or unauthorized structures. The cabin contract contains a provision that specifies the cabin permittee is responsible for the costs of removing unauthorized structures and remediating any environmental damage. The Office is evaluating practicable means of ensuring sufficient funds for*

removing unauthorized structures in an environmentally sound manner for those instances in which the permittee fails to satisfy its contractual obligation for structural removal. Consideration is being given to opportunities presented by the economies of scale resulting from removing multiple structures simultaneously.

5. *The Office has considered whether there are surface lease types which would best serve the State by being issued on a competitive basis. After consideration of the financial and environmental impacts, some lease types in certain circumstances have been found to benefit from, and have been issued using, a competitive bid process. Some examples include the commercial leases of Central Market and the Triangle in Travis County.*

Surface leases are unique in that many of the instruments are issued to adjacent property owners, which does not make them conducive to a competitive bidding process. Also, unlike oil and gas leases, surface leases are not issued in a commodity market. Therefore, different factors must be considered in the lease issuance process, including the impact on the lessee's investment and maintenance decisions; the costs of administering the bidding and amendment process; and changes to the lease term that may be needed to satisfy a competitive market.

6. *The Office has continually revised and strengthened the terms of its lease agreements and would welcome specific suggestions for consideration. The cabin permit was most recently revised to strengthen its terms. It now specifies that no waste may be disposed of on State land and also contains specific configurations for docks and piers, which are intended to reduce the impact on natural resources.*

7. *The Office has been engaged in an effort to terminate cabin permits that are in violation of state law. It should be noted that the cabins in proximity to the Brazoria Refuge were initially granted an exemption from the 1000-foot restriction, which, for many of the cabins, expired in 1998. None of the permits have since been renewed. Also, many of the 66 cabins are addressed in the Christmas Bay Coastal Preserve Management Plan, which will be presented to the SLB for approval on December 12, 2000, and then forwarded to the Parks and Wildlife Commission for ratification. Some of the cabins remain because of the cost of removing the structures and the risk of adverse environmental impact to sensitive habitats. The Office continues to work to resolve the issue in a satisfactory and reasonable manner.*

This page intentionally left blank.