F I S C A L I M P A C T R E P O R T

SPONSOR Fischmann **ORIGINAL DATE** 2/07/09 **LAST UPDATED** 2/26/09 **HB**

SHORT TITLE State Land Lessee Improvement Requirements **SB** 474

ANALYST Woods

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY09	**FY10**		
NFI	NFI		

(Parenthesis ( ) Indicate Expenditure Decreases)

Relates to HBs 605, 606, 607, 610; SB 475

SOURCES OF INFORMATION
LFC Files

Responses Received From
State Land Office (SLO)
Attorney Generals Office (AGO)
Department of Finance and Administration (DFA)

Other Input Received From
Quality Growth Alliance of Dona Ana County

SUMMARY

Synopsis of Bill

This legislation seeks to amend section 19-7-4, pertaining to the sale or lease of state lands upon which there are improvements belonging to another person and requiring payment of compensation to that owner of those improvements, by adding a subsection B, stating that the commissioner of public lands shall not:

(1) define improvements in any manner other than as tangible additions to real property;

(2) waive the requirements of Subsection A of this section or otherwise interpret the provisions of that subsection in a manner that allows payments to a lessee for services rendered rather than payments for improvements, even though the services may increase the value of the land;

(3) enter into any lease or other agreement that provides for the value of improvements to be determined by any other method except an appraisal to be paid for by a subsequent lessee or purchaser; or

(4) otherwise enter into any lease with provisions that are inconsistent with those of subsection A of this section."[1]

There is no appropriation attached to this legislation.

SIGNIFICANT ISSUES

AGO indicates that the phrase "tangible additions to real property," used in paragraph (1), should be changed to read "tangible improvements placed upon real property" and also adding, at the end of that sentence "or otherwise permitted by Section 19-7-15 and 19-7-51." These changes will make it clear that current law allows compensation, under section 19-7-14, for the improvements stated in Section 19-7-15, which references also Section 19-7-51. As stated in N.M. Att'y Gen. Op. 08-02:

> Section 19-7-14 was enacted as part of a legislative package that also included NMSA 1978, Section 19-7-15 and NMSA 1978, Section 19-7-16… Section 19-7-15 defines "improvements" as including water rights and tangible improvements placed upon the land in compliance with NMSA 1978, Section 19-7-51.

SLO indicates the following:

> Under § 19-7-14, "state lands" means the lands granted by the United States to the state in trust for the support of various public institutions, primarily public schools. At present, the trust holds approximately 9 million acres of surface estate and 13 million acres of mineral estate. In granting the land to the state with strict trust obligations and requirements that the land not be sold or leased for more the five years for less than the appraised market value (obligations imposed by the Enabling Act under which New Mexico became a state and incorporated into the New Mexico Constitution, *see* N.M. Const., art. XXI, § 9), the United States sought to ensure that the land would provide the most substantial support possible to the supported institutions. To date, oil and gas development on state trust lands has generated by far the most revenue, but as those resources diminish and residential and commercial development encroaches upon the trust lands, the greatest value of the land to the trust lies in its potential for residential and commercial development.
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> Because the Enabling Act prohibits the state from using trust resources to make improvements on trust lands (*Lake Arthur Drainage Dist. v. Field*, 27 N.M. 183, 199 P. 112 (1921)), the commissioner of public lands must rely on lessees to do real estate planning and development that will allow certain lands to be sold for their highest and best use at a value that brings the greatest return to the trust. If trust land that has potential for such development is sold as undeveloped land, the state will lose out on

[1] Extracted from the AGO response which carries the caveat, *This analysis is neither a formal Attorney General's Opinion nor an Attorney General's Advisory Opinion letter. This is a staff analysis in response to the agency's, committee's or legislator's request.*

untold millions of dollars in potential value. The commissioner of public lands developed a program during a previous administration under which lessees who increase the value of the land through planning and development directed at bringing the land to market at an increased value receive a portion of the proceeds of subsequent lease or sale which reflects the value of the land entitlements and plans obtained or produced by the lessee. In allowing planning and development to occur before the land is sold, this system allows the trust to benefit from the increased value while still operating within the constraints imposed by the Enabling Act. To date, this program has resulted in exponential increases in the value of state trust lands and significant increases in trust revenues. The proposed legislation would prohibit such arrangements and thus deprive the Land Grant Permanent Fund (and New Mexico's education system) of millions of dollars of potential revenue.

PERFORMANCE IMPLICATIONS:

SLO suggests that the proposed legislation would drastically reduce the revenues that state trust lands generate for the Permanent Fund.

ADMINISTRATIVE IMPLICATIONS:

SLO indicates that to the extent that the legislation invalidates existing planning and development leases, it would substantially increase the administrative burdens of the State Land Office in managing those leases.

RELATIONSHIP:

Relates to HBs 605, 606, 607, 610; SB 475

SLO notes the following:

- Under NMSA 1978 § 19-7-15 (1963), "improvements" for purposes of § 19-7-14 must include "appurtenant water rights and all improvements placed upon the land in compliance with Section 19-7-51." It further states that "[a]ppurtenant water rights and improvements placed upon the land . . . may be included by the commissioner in accordance with rules and regulations adopted by the commissioner."

- Under NMSA 1978 § 19-7-51 (1912), a trust land lessee may make "improvements to the land, such as orchards, plowed land, crops, etc." (and receive compensation from a subsequent lessee or purchaser under § 19-7-15), in which case "the amount allowed shall be only the amount added to the natural value of the land by such improvement."

- The proposed legislation would conflict with § 19-7-15 and § 19-7-51.

OTHER SUBSTANTIVE ISSUES

SLO advises that, under N.M. Const., art. XII, § 2, "The commissioner of public lands shall select, locate, classify and have the direction, control, care and disposition of all public lands, under the provisions of the acts of congress relating thereto and such regulations as may be provided by law." Because the commissioner is the trust officer designated by the state to manage the trust lands in accordance with the Enabling Act for the maximum benefit of the supported institutions, the proposed legislation impairs the commissioner's ability to manage and dispose of trust lands in a manner that serves the best interests of the supported institutions

OTHER COMMENTS

Quality Growth Alliance of Dona Ana County offers the following comments on the legislation:

> The bill prohibits intangible improvements from being included in Improvement Value Credits on Business Planning Leases for development, between the State Land Office and various developers.
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> The goal of the legislation is to insure that State Trust Land Beneficiaries receive fair value on the lease and sale of their land for development. Recent deals appear to have rewarded lessees with substantial economic value at the expense of Beneficiaries.
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> The problem is well illustrated by lease number BL-1710 for 323 acres on the East half of section 16 in the Sierra Del Norte Development in Las Cruces. The lessee/developer, Katarina Incorporated, provided planning and road building services that cost the company approximately $500,000. As compensation for these services they will receive (according to the most recent appraisals) a credit toward eventual purchase of the property of up to $11 million. If another developer purchases this land, they will be required to pay Katerina $11 million.
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> The lessee/developer in these arrangements provides worthwhile services to the State Land Office, preparing the land for development and increasing its market value. It is reasonable that they be repaid their expenses and a reasonable profit for that work. But for the lessee/developer to receive more than ten times their expenses as compensation for this work is not reasonable, and deprives the Beneficiaries of those funds.
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> In these arrangements, most of the compensation to the lessee/developer is attributed to increases in property value resulting from "intangible" improvements, such as annexation by the city of Las Cruces, and planning and zoning. Much of this work could have been achieved by direct cooperation between the State Land Office and municipalities or counties without unnecessarily rich compensation to "middlemen" who have been granted planning leases. This bill eliminates unnecessarily rich compensation for "intangible" improvements while still allowing properties to be sold in a condition that will maximize returns to state lands beneficiaries.
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> At least 26 business planning leases are in place or being negotiated. They cover many thousands of acres. Lost revenues from these ill advised arrangements could cost beneficiaries into the hundreds of millions of dollars, with ongoing losses on future leases potentially going into the billions.

We believe this bill will result in a major improvement to the practices of the State Land Office in preparing land for lease or sale for development, resulting in significant increases in compensation to the Beneficiaries.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

SLO states: "The Land Grant Permanent Fund will receive millions of dollars of revenue that likely will not be realized if the bill becomes law."

AMENDMENTS

None suggested by respondents.

BW/mt