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June 27, 2019

VIA EMAIL

The Honorable Ronald D. Kouchi
Senate President
415 South Beretania Street
Hawai'i State Capitol, Room 409
Honolulu, Hawai'i 96813

VIA EMAIL

The Honorable Scott K. Saiki
Speaker, House of Representatives
415 South Beretania Street
Hawai'i State Capitol, Room 431
Honolulu, Hawai'i 96813

Re: *Audit of the Department of Land and Natural Resources' Special Land and Development Fund*, Report No. 19-12

Dear President Kouchi and Speaker Saiki:

We are attaching a copy of our *Audit of the Department of Land and Natural Resources' Special Land and Development Fund*, Report No. 19-12, along with a copy of the Auditor's Summary, which has also been uploaded to the Legislature's web-based application.

This report is being issued pursuant to Act 209, Session Laws of Hawai'i 2017, and is a report on the Special Land and Development Fund.

The report and summary are also accessible through the Office of the Auditor's website at:

http://files.hawaii.gov/auditor/Reports/2019/19-12.pdf;
and
http://files.hawaii.gov/auditor/Overviews/2019/19-12AuditorSummary.pdf.

If you or other Legislators would like a printed version of the report, please let me know.

Very truly yours,

Leslie H. Kondo
State Auditor

LHK:emo

Attachments
ec/attach: Senators
Representatives
Carol Taniguchi, Senate Chief Clerk
Brian Takeshita, House Chief Clerk

Auditor's Summary

Audit of the Department of Land and Natural Resources' Special Land and Development Fund

Report No. 19-12

PHOTO: ISTOCK.COM

The absence of long-range planning has left the Land Division staff without the expertise, resources, and options to actively and effectively manage its land portfolio.

THE DEPARTMENT OF LAND AND NATURAL RESOURCES' (DLNR) land portfolio contains more than 1,600 income-generating properties that produce substantial revenue through the issuance of long-term leases and one-year revocable permits. Those proceeds are held with other revenues in the Special Land and Development Fund (SLDF), which DLNR relies on to fully fund its Land Division, the Office of Conservation and Coastal Lands, and the Engineering Division's Dam Safety and Geothermal programs, as well as supplement the budgets of other offices and divisions within the agency. Since it was statutorily created in 1962, the SLDF has become a critical funding source for natural disaster response, hazard mitigation, and conservation programs, as well as providing state matching funds for federally funded endangered species and invasive species initiatives.

What we found

Our audit focused on the Land Division's management of its public lands and its administration of the SLDF. We found the Land Division lacking in both areas. Specifically, the Land Division does not have a strategic plan for the long-term management of its public lands, an asset management plan to optimize revenue in keeping with its public trust obligations, and clear and coherent policies and procedures to guide its day-to-day operations. The absence of long-range planning has left the Land Division staff without the expertise, resources, and options to actively and effectively manage its land portfolio. Not only is the division ill-prepared to take advantage of opportunities to enhance revenues for the State, the division cannot perform two core lease management functions: collecting delinquent rent and performing annual field inspections. Due to these shortcomings, lease extensions have become the norm, which potentially benefits a few lessees at the cost of foregoing substantial state revenues and denying the wider public new opportunities to lease state land. Similarly, most of the Land Division's "temporary" revocable permits are decades old, which has allowed a number of tenants to continue using thousands of acres of public land, many at less than fair market rates.

When it comes to administration of the SLDF, we found DLNR does not accurately account for moneys in the special fund and underreported cash balances to the 2018 Legislature by more than $1.5 million. It has also allowed more than $1.5 million to sit idle in the SLDF for more than five years.

How did these problems occur?

The Land Division Administrator believes that Chapter 171, Hawai'i Revised Statutes, provides all the guidance the division needs to manage its public lands, so he does not see the need for administrative rules or written policies and procedures. He also does not see the benefit in long-range planning, as the division's direction can shift whenever there is a change in administration or board composition. But this short-range thinking has left the Land Division unprepared to strategically grow its income in terms of staffing, expertise, and resources; for instance, land agents are trained to issue ground leases, but not space leases that could yield higher rents.

The Land Division and the Land Board have been entrusted with public lands and, per the Attorney General, have a fiduciary duty to manage that trust solely in the interest of its beneficiaries, the people of Hawai'i; to deal impartially when there is more than one beneficiary; and to use reasonable skill and care to make trust property productive. Some Board of Land and Natural Resources members seem to misunderstand their public trust responsibilities, however. They do not believe these responsibilities include maximizing income to the extent possible. Rather, they cite the need for balance, fairness, reasonableness, and retention of good tenants, which we believe is putting the interests of individual lessees above those of the rest of the public.

The Land Division, meanwhile, has already missed opportunities to increase income for the State. For example, when 70 leases in the Kanoelehua Industrial Area on Hawai'i Island began expiring in 2014, the Land Division had an opportunity to consolidate and re-subdivide properties to meet growing demand for 2- to 3-acre parcels, as well as to let the ground leases expire and be converted to space leases. By our calculation, extending just 16 of the leases instead meant the State lost out on $1.6 million in potential revenue. In addition, by not adjusting rents as required by statute, many tenants are paying well-below market rates. An appraisal of just 113 of the Land Division's 340 revocable permits by CBRE, Inc., showed the Land Division's rent was nearly $838,000 below market rates.

We further found that DLNR misunderstands its own special fund, which is reflected in its reports to the Legislature. For instance, DLNR reported that the SLDF is comprised of only two accounts when it is, in fact, comprised of 25 accounts. Compounding matters, we determined that DLNR did not report 15 of the SLDF sub-accounts on its non-general funds report to the Legislature, consequently understating the total SLDF balance by more than $1.5 million and preventing the Legislature from considering the use of excess moneys for other public purposes.

Why do these problems matter?

DLNR and the Land Board's inability to do anything but maintain the status quo has led to a loss of revenue for the State, as well as a loss of opportunities for potential lessees to lease public lands. Further, special funds are created for specific programs and purposes and cannot be used for anything else. Inaccurate reporting obscures whether the funds are being used appropriately, as well as if there are excess moneys that could be moved into the general fund to address other priorities within and outside of DLNR.

Audit of the Department of Land and Natural Resources' Special Land and Development Fund

A Report to the Governor
and the Legislature of
the State of Hawai'i

Report No. 19-12
June 2019

OFFICE OF THE AUDITOR
STATE OF HAWAI'I

OFFICE OF THE AUDITOR
STATE OF HAWAIʻI

Constitutional Mandate

Pursuant to Article VII, Section 10 of the Hawai'i State Constitution, the Office of the Auditor shall conduct post-audits of the transactions, accounts, programs and performance of all departments, offices and agencies of the State and its political subdivisions.

The Auditor's position was established to help eliminate waste and inefficiency in government, provide the Legislature with a check against the powers of the executive branch, and ensure that public funds are expended according to legislative intent.

Hawai'i Revised Statutes, Chapter 23, gives the Auditor broad powers to examine all books, records, files, papers and documents, and financial affairs of every agency. The Auditor also has the authority to summon people to produce records and answer questions under oath.

Our Mission

To improve government through independent and objective analyses.

We provide independent, objective, and meaningful answers to questions about government performance. Our aim is to hold agencies accountable for their policy implementation, program management and expenditure of public funds.

Our Work

We conduct performance audits (also called management or operations audits), which examine the efficiency and effectiveness of government programs or agencies, as well as financial audits, which attest to the fairness of financial statements of the State and its agencies.

Additionally, we perform procurement audits, sunrise analyses and sunset evaluations of proposed regulatory programs, analyses of proposals to mandate health insurance benefits, analyses of proposed special and revolving funds, analyses of existing special, revolving and trust funds, and special studies requested by the Legislature.

We report our findings and make recommendations to the Governor and the Legislature to help them make informed decisions.

For more information on the Office of the Auditor, visit our website:
http://auditor.hawaii.gov

Foreword

Our audit of the Department of Land and Natural Resources' Special Land and Development Fund was conducted pursuant to Act 209, Session Laws of Hawai'i 2017. Act 209 requires the Auditor to conduct a performance audit of DLNR's Land Conservation Fund and Special Land and Development Fund. Our report on the Land Conservation Fund and the Legacy Land Conservation Program was released in January 2019.

We express our sincere appreciation to the officers and staff of the Department of Land and Natural Resources, members of the Board of Land and Natural Resources, and other individuals whom we contacted during the course of our audit, for their cooperation and assistance.

Leslie H. Kondo
State Auditor

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PHOTO: ISTOCK.COM

The Public Trust vs. Good Tenants: Audit of the Department of Land and Natural Resources' Special Land and Development Fund

Introduction

THE STATE OF HAWAI'I'S Department of Land and Natural Resources' (DLNR) Land Division is responsible for managing, administering, and controlling state-owned lands in ways that will promote the social, environmental, and economic well-being of Hawai'i's people and for ensuring that these lands are used in accordance with the goals, policies, and plans of the State. This includes planning for the use and development of state lands; leasing lands for agricultural, commercial, industrial, renewable energy, and resort purposes; issuing revocable permits and easements; and ensuring the availability of lands for public purposes.

In our audit, we found that the Land Division is not fulfilling its mission. It has neither a strategic plan for the long-term management of its public lands, nor an asset management plan to identify and fulfill its obligations and goals related to the administration of these lands. For instance, the expiration of its leases in the Kanoelehua Industrial Area on Hawai'i Island beginning in 2014 should have been an opportunity to consolidate

The Land Division's mission is to ensure effective and efficient use of these public lands in ways that will fulfill the public trust obligations and promote the sustained social, environmental, and economic well-being of Hawai'i's people.

We found that the Land Division is not fulfilling its mission.

and re-subdivide the property, which would have opened up additional leasing opportunities to the public and increased revenues for the State. But the Land Division did not prepare for this eventuality, and when the lease expiration dates were imminent, the Land Division did not have the staff, expertise, and resources to do anything other than continue business as usual, and left the Board of Land and Natural Resources (Land Board) with little choice but to extend the leases. As a result, lease extensions have since been the norm, which is a practice that primarily benefits the current tenants and raises questions about whether the division's actions were consistent with its public trust responsibilities.

However, the Land Division Administrator does not see the necessity of such planning, explaining that the division's focus and direction often change "on a dime," especially during changes in administration or board composition. On the contrary, we believe a long-range, strategic plan is precisely what provides an agency with the direction and guidance that are needed during transitions of leadership.

We also found that the Land Division lacks clear and consistent policies and procedures necessary to guide day-to-day operations. Without them, the Land Division does not adequately perform two of its four core lease management functions: (1) it has significant difficulties collecting delinquent rent; and (2) it does not perform field inspections to ensure compliance with lease terms, including lessees' obligation to upkeep and maintain leased premises.

In short, the Land Division is ill-prepared for the current and future demands of public land management, unable to resolve its present challenges, and not planning for opportunities in the future. In addition, the Land Board is not fulfilling its duty to promote the development and utilization of Hawai‘i's natural resources according to principles that will assure their highest economic and social benefits to the State.

Background

The Department of Land and Natural Resources

DLNR is established under Section 26-15, Hawai‘i Revised Statutes (HRS), and its jurisdiction is outlined in Chapter 171, HRS. Its mission is to "[e]nhance, protect, conserve and manage Hawai‘i's unique and limited natural, cultural and historic resources held in public trust for current and future generations of the people of Hawai‘i[.]" DLNR is responsible for nearly 1.3 million acres of state lands, beaches, and coastal waters as well as 750 miles of coastline. These lands are held in trust by the State for the benefit of Hawai‘i's people.

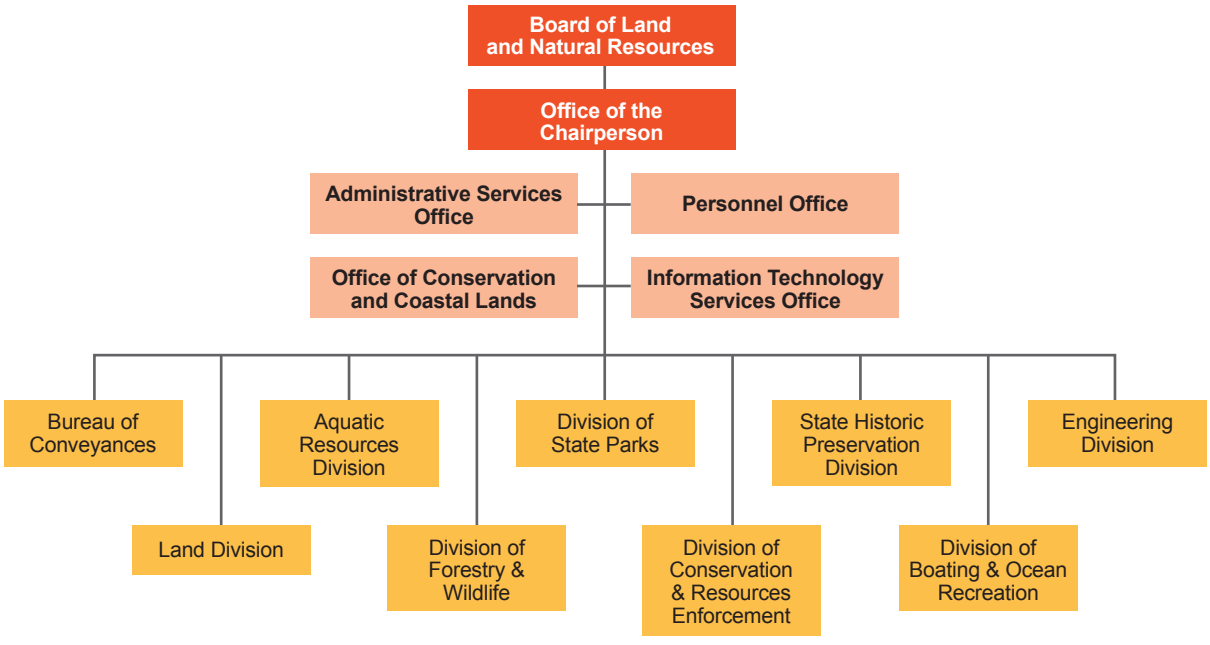
The Board of Land and Natural Resources

The Land Board is composed of seven members, one from each county and three at large, who are appointed to four-year terms by the Governor with the advice and consent of the Senate. The Land Board members must come from each county and at least one member must have a background in conservation and natural resources, another must have a background in Native Hawaiian traditional and customary practices, and no more than three members on the Land Board may be from the same political party. The Governor also appoints the Chairperson of the Land Board from among its members. The Chairperson also serves as the chief executive officer of the department.

DLNR Divisions and Offices

DLNR consists of nine divisions: Aquatic Resources, Boating and Ocean Recreation, Bureau of Conveyances, Conservation and Resources Enforcement, Engineering, Forestry and Wildlife, Historic Preservation, Land, and State Parks, as well as administratively attached boards and commissions. The Office of the Chairperson, Administrative Services Office, Personnel Office, Information Technology Services Office, and the Office of Conservation and Coastal Lands are offices within DLNR.

Exhibit 1
DLNR Divisions and Offices



Source: Department of Land and Natural Resources

Special Funds

ACCORDING TO the State's Accounting Manual, special funds are funds used to account for revenues earmarked for particular purposes and from which expenditures are made for those purposes.

Special funds exist outside the State's main financial account, the general fund. One example is the Diamond Head State Monument account, which contains a portion of the user fees and other moneys collected for the use of its hiking trail. The funds are used for the operation and maintenance of the monument, among other things.

In FY2019, special funds comprised 20 percent of the State's $14.3 billion operating budget.

Special Land and Development Fund

The Special Land and Development Fund (SLDF) was statutorily created in 1962 and today holds proceeds from the sale of public lands; mineral and water rights; rents from leases, licenses, and permits; fees, fines, and other administrative charges included in Chapter 171, HRS (Management and Disposition of Public Lands); a portion of the highway fuel tax; moneys for the commercial use of the public trails and access; and a portion of transient accommodations tax revenues.

The SLDF, one of 18 DLNR special funds, is the funding source for the entire annual operating budget of the Land Division, the Office of Conservation and Coastal Lands, and the Engineering Division's Dam Safety and Geothermal programs. The SLDF also funds other positions within DLNR, including three within the Commission on Water Resource Management, and provides funding support to the Division of State Parks and various resource protection programs administered by the Division of Forestry and Wildlife.

The SLDF is a critical and increasingly important funding source for various divisions within DLNR to respond to natural disasters such as fire, rockfall, flood or earthquake, and hazard investigation and mitigation. The SLDF is also critical for staff support of various programs and funds conservation projects on all state lands. It has also become an important source of state matching funds for federally funded endangered species and invasive species initiatives that otherwise would not go forward. See Appendix B for details of the SLDF revenues, expenditures, transfers, and fund balance for FY2015 – FY2017.

Audit Objectives

1. Evaluate DLNR's processes related to the land management of leases and permits.

2. Evaluate DLNR's accounting and reporting related to rent collection.

3. Determine the propriety of expenditures of the SLDF, including transfers to other DLNR programs.

4. Make recommendations as appropriate.

Impetus, Scope and Methodology

We conducted this audit pursuant to Act 209, Session Laws of Hawai‘i 2017 (House Bill No. 839, House Draft 1, Senate Draft 1, Conference Draft 1). Act 209 requires the Auditor to conduct a performance audit of DLNR's Special Land and Development Fund and Land Conservation Fund, including a review of contracts, grants, and memoranda of understanding entered into, awarded by, or otherwise involving those funds during the period July 1, 2015, through June 30, 2017, to determine whether funds were expended in compliance with laws and contractual agreements. We contracted with the certified public accounting firm KKDLY LLC (KKDLY) to review DLNR's administration of the SLDF. The procedures performed by KKDLY are described in Appendix A.

This audit report focuses on the Land Division's management of its public lands, particularly its revenue-generating leases and revocable permits, which provide the majority of the SLDF's revenues. The report also examines the Land Division's and DLNR's administration of the SLDF during the period FY2016 through FY2017, but where appropriate, includes information from other years. Our audit of the Land Conservation Fund was issued in January 2019, Report No. 19-01, *Audit of the Department of Land and Natural Resources' Land Conservation Fund.*

This audit was conducted from June 2017 through December 2018, 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. We believe the evidence we obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

To achieve our audit objectives relating to the management of leases and permits and the financial management of the SLDF, we reviewed relevant statutes, policies and procedures, and other written guidance related to the fund's activities. We examined contracts, leases, permits, financial records, annual reports, public meeting minutes, and other relevant documents. We also interviewed members of the Land Board, the Land Division Administrator and Land Division staff, and other DLNR staff who assist in overseeing and administering the SLDF and its related programs and activities.

Summary of Findings

1. Without a strategic plan for its public lands, the Land Division's management of leases and revocable permits defaults to maintaining the status quo rather than exploring higher and better use.

2. Lack of complete and coherent policies and procedures prevents the Land Division from adequately managing its leases and revocable permits.

3. Lack of transparency and accountability hinders the administration of the Special Land and Development Fund.

Without a strategic plan for its public lands, the Land Division's management of leases and revocable permits defaults to maintaining the status quo rather than exploring opportunities for higher and better use.

DLNR has more than 1,600 income-generating properties in its land portfolio, which provide substantial revenue through the issuance of long-term leases and one-year revocable permits. The Land Division receives no state general funds, relying on income from its leases and revocable permits to fully fund its operations. However, we found that strategically growing this income has not been a priority – or even a possibility – since the Land Division's lack of long-range planning has left its staff without the expertise, resources, or options to actively and effectively manage its land portfolio.

The resulting impact on the SLDF's bottom line is likely considerable. During the period covered by our audit, leases of state-owned land in two industrial parks accounted for more than $11 million of the Land Division's annual budget: 70 leases in the Kanoelehua Industrial Area (KIA) represent 10 percent of the Land Division's funding, while the 111 lot-property at Sand Island Industrial Park accounts for nearly 50 percent. Although this rental income is sizeable, our analysis showed it could be much higher. Specifically, by extending ground leases rather than allowing the leases to expire and issuing new leases at substantially higher amounts, we calculate that the Land Division lost annual revenue opportunities totaling $1.6 million for just 16 KIA leases; and it remains to be seen whether the State will be able to collect fair market rent on its Sand Island properties, where the Land Division fixed annual base rents for the master lease far into the future (through the end of FY 2057), despite lease provisions requiring rent redeterminations to reflect current market rates every 10 years.

When it comes to revocable permits, the Land Division is leaving even more of the State's money on the table. DLNR hired a contractor to appraise about one-third of the Land Division's approximately 340 revocable permits who determined that annual rent for 2018 for those permits was $838,000 below market values. Since only a third of the Land Division's revocable permits were appraised, an estimate of total lost revenue to the State is likely substantially higher.

DLNR/Land Division does not have an overarching plan for the management of public lands.

Long-range planning provides overall policy direction and guiding principles for managing the State's assets. In addition, an asset management plan provides the framework to maximize revenue commensurate with public trust obligations. We found that the Land Division drafted a five-year plan covering the period July 1, 2010, to June 30, 2015. The draft plan emphasized improvements to document processing and set "bigger picture goals," such as increasing revenues and reducing liability to the State and DLNR. Some of the goals included identifying parcels that could be put out for public auction to generate revenue and developing a plan to conduct inspections of state lands. However, the plan was never implemented.

The Land Division Administrator is doubtful that a long-range plan would benefit the division's land management efforts. He explained that, having served under several state administrations, he has seen priorities change "on a dime" upon the arrival of a new governor, chair, or board members. As an example, he cited a previous Governor's initiative to develop urban lands on Maui. In contrast, the current Governor has made the development of Land Division holdings along the Honolulu Area Rapid Transit rail line in East Kapolei a priority. The Land Division is currently working on both projects.

While we recognize the Land Division Administrator's concerns about shifting priorities, periodic changes in administrative priorities should not preclude the Land Division from ensuring the State gets an optimal return on the holdings in its land portfolio over the long-term. On the contrary, the Land Division Administrator's observations highlight the importance of providing the Land Board, DLNR, and the Land Division with both a long-range strategic plan and guidance that provide consistency through transitions in leadership. In addition, an asset management plan, which would address the reclassification and redevelopment of lands, could enhance SLDF revenue. For instance, the Land Division has neither a plan for evaluating the inventory of properties available for disposition, nor a formal marketing plan or strategy. State law requires that public notice of any proposed disposition by auction shall be given at least once statewide and once in the county where the land is located. According to the Land Division's former planning and development manager, procedures for marketing properties include posting a sign on the lot being auctioned and running a single notice in the newspaper. He said that he had worked to engage real estate brokerage firms to develop an asset management and marketing strategy but was instructed by the Land Division Administrator and Assistant Administrator to stop pursuing it.

The lack of well-defined procedures and an overall plan are not simply theoretical niceties. With regard to the Land Division's management of some of the major sources of funding for the SLDF, these shortcomings can and have led to inefficiencies, lost opportunities, and lost revenue. We detail some specific examples in the rest of this report.

The Public Trust vs. "Good Tenants"

THE PUBLIC TRUST DOCTRINE requires government stewardship of the natural resources upon which society (and, by extension, our economy and government) depends for continued existence. The public trust doctrine has been called "the oldest expression of environmental law," with roots that extend at least as far back as sixth-century Rome. Under the public trust doctrine, the trust property consists of natural resources. The government is the trustee of these natural resources and must manage them subject to fiduciary duties, for the benefit of both present and future generations, who are beneficiaries of the public trust.

In 2018 testimony before a state House committee regarding the redevelopment of KIA and the Banyan Drive area of Hilo, the Department of the Attorney General (Attorney General) clarified the State's public trust responsibilities. According to the Attorney General, the State is required to deal with the public trust not just as a business manager, but as a trustee with fiduciary responsibilities to its beneficiaries. The Attorney General identified three specific trustee obligations to the State: "(1) the obligation to administer the trust solely in the interest of the beneficiary; (2) the obligation that the trustee deal impartially when there is more than one beneficiary; and (3) the obligation to use reasonable skill and care to make trust property productive."

However, there appears to be a misunderstanding among some Land Board members about their public trust responsibilities. Four of the seven Land Board members told us that while they are aware of their obligations to beneficiaries, they do not believe it to include maximizing income to the extent possible. Instead the Land Board members cited the need for balance, fairness, reasonableness, and retention of good tenants.

"If you have a good tenant, you should do what you can to keep the tenant," said one Land Board member who had previously worked as a Land Division land agent.

In addition, according to a September 2018 DLNR memo, some members of the Land Board believe there is a public interest in extending the KIA leases, since doing so maintained economic stability in East Hawai'i. "Denying lease extensions places lessees in the difficult position of not knowing whether they will be able to continue operations at their existing locations past the termination date of their leases, and makes them reluctant to expend funds on repairs and maintenance of aging improvements," DLNR wrote. According to DLNR, allowing the leases to expire and putting the properties up for auction "with the sole objective of maximizing rents for the State," is an overly narrow view of the public trust doctrine. The State's lessees are members of the public, DLNR pointed out.

We disagree with this interpretation. We believe that putting the interests of individual lessees above those of the rest of the public is an overly narrow interpretation of the public trust doctrine and raises questions about whether the Land Board members are fulfilling their fiduciary responsibilities.

Substantial Extension for Substantial Improvements?

ACT 149, SLH 2018, established a 10-year pilot project to authorize the Land Board to extend leases of public land in an area designated as the Hilo community economic district to facilitate efficient, effective improvement, and economic opportunity in the area for lessees who commit to making "substantial improvements" to the existing improvements or constructing new "substantial improvements."

Act 149 defined substantial improvements as "any renovation, rehabilitation, reconstruction, or construction of the existing improvements, including minimum requirements for off-site and on-site improvements, the cost of which equals or exceeds 30 percent of the market value of the existing improvements that the lessee or the lessee and developer install, construct, and complete by the date of completion of the total development."

Act 149, which was passed in 2018 after the first round of KIA lease extensions, also allowed the Land Board to extend the term of a lease so long as the length of any extension does not extend the original lease term by more than 40 years. We reviewed 16 KIA lease extensions that were extended for 10 years and approved prior to the passage of Act 149 and found that the improvements for 10 of them would not have qualified as substantial improvements, since costs did not reach the 30 percent threshold. In fact, the cost of the improvements for four of the KIA lease extensions granted was less than 10 percent of the market value of existing improvements.

The Land Division was ill-prepared for the recent expiration of KIA leases, denying the wider public of potential leasing opportunities and the State of the possibility of enhanced revenue.

DLNR owns approximately 59 acres of land in KIA, an urbanized region in the vicinity of the Hilo International Airport. The State began issuing leases in the area following the aftermath of the 1960 tsunami, which destroyed and damaged more than 500 homes and businesses in downtown Hilo. Many of KIA's 70 industrial, commercial, and utility leases were awarded during a two- or three-year period in the early 1960s. In 2014, the KIA leases generated $2.1 million in annual lease revenue for the State, with about a third of the 55-year leases set to expire in 2016.

We found that the Land Division did not plan for this eventuality and still does not have long-term plans for the management of this area, which could include the reclassification and redevelopment of the properties. Instead, with expiration of the KIA leases imminent, the Land Division did not have the capacity – staff, expertise, funding, or strategy – to handle anything other than the status quo, resulting in lease extensions that may benefit a few lessees at the cost of foregoing substantial state revenues.

The Land Division did not have a plan or the capability to let leases expire and redevelop KIA properties.

The department's KIA leases generally provide that the lessee owns improvements to the property it constructs during the term of the lease, but that ownership of the improvements, including buildings and other structures, reverts to the State without compensation when the lease ends. Lessees, at their own expense, are responsible for repairing and maintaining all buildings and other improvements on their properties throughout the lease term. Upon the expiration or termination of the lease, the lessee must surrender the property together with all buildings and other improvements to DLNR.

In 2011, the Legislature passed Act 207, Session Laws of Hawai'i (SLH) 2011, allowing the Land Board to extend KIA leases to a maximum term of 65 years under certain circumstances. Specifically, the Act allowed DLNR to extend the leases up to an aggregate term of 65 years, including the initial term and any extension, provided extensions are necessary to qualify for mortgage lending or to amortize the cost of self-financed improvements to the premises. Lessees were advised by DLNR that, even if they met statutory requirements for an extension, the decision to grant the extension was at the Land Board's discretion.

The extensions granted to KIA lessees go against the public policy of opening state lands for competitive bidding or another public disposition process to provide opportunities for new lessees to lease state lands. By extending leases instead of allowing leases to expire, the State also lost the opportunity to receive market rents based on improved land.

To estimate the potential revenue that allowing the ground leases to expire and issuing new space leases could provide to the State, we took the square footages of the buildings and other improvements for each of the 16 KIA properties with extended leases from Hawai‘i County real property tax records and multiplied them by the commercial space lease rent rate for Hilo, which was $0.84 square foot per month in 2014. The following table shows that by extending these 16 KIA leases, the State was forgoing the opportunity to potentially earn nearly $1.6 million more annually, or $16 million over the 10-year extension period.

Exhibit 2
Deep Discounts

Tenant	Building Sq. Ft.*	Current Annual Ground Rent	Potential Annual Space Lease Rent**	Annual Lost Revenue Opportunity
Yamada Consolidated, Inc.	44,644	$85,800	$450,012	$364,212
69 Railroad, LLC	44,008	$127,384	$443,600	$316,216
JH Moku Ola, LLC	24,652	$70,700	$248,492	$177,792
Hawaiian Fresh Products, Inc.	17,978	$18,480	$181,218	$162,738
Crescent City Properties, Inc.	18,336	$30,000	$184,827	$154,827
The Food Basket, Inc.	10,486	$3,000	$105,699	$102,699
Central Supply, Inc.	11,040	$22,500	$111,283	$88,783
BCI Coca-Cola Bottling Co.	11,960	$32,400	$120,557	$88,157
Automotive Supply Center, Ltd.	7,520	$16,320	$75,802	$59,482
Jieyu Shepard	6,560	$19,635	$66,125	$46,490
Machida, Inc.	5,000	$14,750	$50,400	$35,650
Lesley Hill	3,840	$17,940	$38,707	$20,767
Hiroshi Matsubara	2,304	$13,100	$23,224	$10,124
Mattos Electric, LLC	2,260	$15,120	$22,781	$7,661
Roger Antonio, dba Antonio’s Repair	1,850	$12,840	$18,648	$5,808
Chika Nakano Repair Shop, Inc.	2,300	$27,600	$23,184	$(4,416)
			Total:	**$1,636,990**

* Building square footage obtained from Hawai‘i County Real Property Tax records.

** Based on commercial lease rates ($0.84 per square foot per month) according to CBRE Hawai‘i Research. For Hawai‘i Island, the industrial triple net lease rate (tenant pays property tax, insurance, maintenance, utilities, and janitorial services) is $0.84, whereas, the industrial gross rate is $1.11. For our purposes, we are using the more conservative triple net lease rate. However, it should be noted that the fair market rents are statutorily required to be based on appraisals, rather than prevailing square foot industrial lease rates.

Source: Office of the Auditor

"I take the blame for having a soft heart for these KIA people," he said. "But if you have a good tenant, you want to keep them."

– Land Board member

The first KIA lease extension request was considered by the Land Board in December 2012. The Land Division recommended the Land Board reject the extension because, at less than one acre, the subject parcel was an underperforming asset for the State. The Land Division's recommendation noted a growing market demand in Hilo for light industrial parcels in the two- to three-acre range and, since leases for another eight contiguous properties of similar size were also set to expire in early 2016, suggested consolidating and re-subdividing all nine parcels into two or three larger lots. The Land Division also pointed out that, because the improvements revert to the State upon expiration of the lease, the State would likely generate higher lease rents for improved land rather than extending the existing ground leases for 10 years, which would likely "perpetuate the underperformance of the land and the adjoining lots for the same period."

According to the former Land Board Chair and other Land Board members at the time, the Land Division did not have the capability to implement this strategy by itself. The former Land Board Chair believed that the impending lease expirations were an opportunity to pursue a master lease with a third-party to manage the area. This is the business model DLNR has used to manage its land holdings on Oʻahu's Sand Island since 1992. **(See "An Island Unto Itself" on page 14.)** To do so, he believed that DLNR would have to consolidate the parcels, which would mean allowing the leases to expire; however, at its December 14, 2012, meeting, the Land Board rejected the Land Division's recommendation and granted the extension to the lessee.

According to the former Land Board Chair, the initiative to consolidate and re-subdivide parcels failed because Land Board members generally defer to the member or members from the island on which the properties are located. When we asked a current Land Board member from Hawaiʻi Island about the extension of KIA leases, he candidly admitted that many of the lessees were his friends, and he wanted to give them a chance to extend their leases, as he believed was appropriate under the law. The Land Board member is a former legislator who represented the Hilo district, and he told us that some of the KIA lessees are former political supporters and close friends. "I take the blame for having a soft heart for these KIA people," he said. "But if you have a good tenant, you want to keep them."

The former Land Board Chair also stated that once the first lease extension was approved, the opportunity to pursue a master lease was diminished. In addition, he believes that the Land Division did not, and does not, have the staff or the expertise to serve as a property manager. "Land transactions are much more complex today," he said. "A property manager 20 years ago is not the same as now."

The Land Division Administrator had a similar assessment of his staff's capabilities: He stated that land agents are trained to do ground leases and are not property managers.

Since that first lease extension was granted in 2012, the Land Board has approved all KIA lease extension requests.

Greater Rent, Greater Responsibility

Conversion from ground leases to space leases could mean substantially higher rents for the State, but at what cost?

THE LAND DIVISION issues ground leases for more than 1,300 income-generating properties in its inventory. Ground leases allow the State to retain ownership of the land, while the lessee owns any improvements it constructs for the duration of the lease. Under this landlord-tenant relationship, the lessee pays rent based on the unimproved land value but also pays for the repair and upkeep of all buildings and improvements now existing or later constructed. When the lease is terminated, all buildings and other improvements must be surrendered to the State, which auctions the lease of the property and its improvements at a fair market rate.

Under a space lease, the lessor rents out a space on the improved property and is responsible for the repairs, maintenance, and any necessary improvements to the property. But Land Division management and its land agents stated they do not have the staffing, training, and resources necessary to convert the ground leases to space leases.

We found that the State of Oregon engages private-sector brokers and property managers to administer space leases, when cost effective. However, the Land Board Chair noted that brokerage services are not one of the professional services identified in the State Procurement Code. Procurement through a small purchases contract would require selection of the lowest bidder, however, brokers are normally paid a commission and it is not clear whether DLNR has the authority to pay a commission as opposed to a negotiated rate. In addition, the Land Division Administrator noted that, in the private sector, leases are issued by direct negotiation, however, the statute requires that leases be issued through public auction. Therefore, the broker would have to be willing to follow the auction process required under the statute.

We note that these requirements are not so unusual or overly restrictive. In fact, the Hawai‘i Public Housing Authority contracts property management services through a request for proposals.

PHOTO:OFFICE OF THE AUDITOR

An Island Unto Itself

For the Sand Island Industrial Park, its master lessee – not the State – calls the shots.

SAND ISLAND INDUSTRIAL PARK is a 73-acre, 111-lot industrial property in urban Oʻahu, which, since 1992, has been managed by the Sand Island Business Association (SIBA) under a 55-year master lease with the State of Hawaiʻi. In 2017, the park's $4.9 million in rent to the State accounted for 45 percent of the SLDF's total lease revenue of $10.9 million that year, making it the largest single revenue generator in the Land Division's portfolio of leases. However, despite this significant financial contribution – or perhaps because of it – SIBA has been allowed to develop and operate the industrial park with little regard for requirements in the master lease agreement with the State. In addition, SIBA has requested and received generous accommodations that have fixed the industrial park's rent to the State far into the future. While setting rents nearly four decades in advance may provide SIBA's tenants with the "ability and flexibility of financing, refinancing leasehold improvements, maintenance and repair," these early agreements expose the State to the risk of being locked into below-market rates. The Sand Island Industrial Park sits on public lands, and the Land Division should be employing leasing management practices that protect the interests of the State, not only those of SIBA's tenants.

Infrastructure completed in 1999 but yet to be dedicated

The master lease requires SIBA to develop infrastructure improvements, such as roads, storm and sewer drains, and utilities necessary for the development of the industrial park. Accordingly, the annual rents for the first 25 years were discounted to allow SIBA to recover its costs for infrastructure improvements. For the first 5 years annual base rent was set at $1.2 million, years 6 – 10: $3.1, years 11 – 20: $3.8 million, and years 21 – 25 was $4.9 million.

SIBA completed the park's infrastructure improvements in 1999 and, according to the master lease, is required to dedicate the infrastructure to the City and County of Honolulu (City); however, SIBA has kept the roads private for security purposes, gating the entrance into the park nightly. According to the department, SIBA's failure to dedicate the infrastructure adversely affects the value of the property for the State. Conversely, the possession of a private road, which allows public access to be restricted, adds value to the property, a benefit we believe SIBA should pay for. On April 26, 2013, DLNR issued a Notice of Default to SIBA for failing to dedicate the infrastructure improvements and gave the master lessee 60 days to resolve the matter. SIBA responded about two months later that it was not in default since the lease did not set a deadline for when the dedication must be completed. The issue remains unresolved.

The Land Division Administrator admitted to being unsure of the status of the sewer dedication. He believed that Hawaiian Electric Company, Inc. has been granted an easement to underground electrical lines. In addition, he thought SIBA was close to dedicating the water lines to the Honolulu Board of Water Supply; however, he said the City has been

While setting rents nearly four decades in advance may provide SIBA's tenants with the "ability and flexibility of financing, refinancing leasehold improvements, maintenance and repair," these early agreements expose the State to the risk of being locked into below-market rates.

unwilling to take over the sewer service for the property, since SIBA hasn't dedicated the road.

Early rent re-determinations benefit SIBA tenants, expose State to risk

According to the master lease, at least six months prior to the 26th year, an appraiser, appointed and paid for by DLNR, determines the fair-market base rent for the industrial park and conducts rent re-determinations at intervals of 10 years thereafter for the remainder of the term of the lease. However, SIBA requested an early appraisal and a subsequent rent re-determination because it claimed that its tenants needed to obtain financing and waiting till 2017 to find out their rent for the next decade prohibited or severely restricted their ability to do so.

DLNR met with SIBA, requesting that it provide additional information regarding its tenants' financing needs, including how many tenants were seeking financing and the purposes and amounts of the financing being sought. The department concluded that there was no evidence that long-term real estate-secured financing was required by a substantial number of SIBA's tenants. Nevertheless, DLNR agreed to push up the rent re-determination process, and the subsequent appraisal set the industrial park's annual base rent at $9.3 million per year from July 1, 2017 to June 30, 2022. After the five years, base rent would increase to $11.4 million from July 1, 2022 to June 30, 2027.

Even though the master lease specifies that the re-determination of fair market rent should be done every 10 years, SIBA requested an appraisal be done from which annual base rent could be determined for an additional 30 years, from July 1, 2027 to June 30, 2057, 10 years beyond the master lease. SIBA made a similar claim that certainty about future rents would provide its tenants with the ability and flexibility of financing, refinancing leasehold improvements, maintenance, and repair.

In its 2013 submittal to the Land Board, the Land Division wrote, "Conducting the reopening early was not the Department's preference because it puts the State at risk if the real estate market improves in a manner not anticipated in the appraisal." The second appraisal was completed in 2015 with estimated base rents that ranged from $13.6 million per year (2027 – 2032) to $30.2 million (2052 – 2057). SIBA accepted the annual base rents in October 2015.

Free parking – for nearly 30 years?

Under the master lease, SIBA has the right to occupy space on a 1.3-acre parcel known as the "Commercial Center": 1,000 square feet of loft office space at no cost, and up to an additional 2,000 square feet of office space at fair market rent. SIBA currently occupies a 784-square-foot office and two 400-square foot carports that house a car each. SIBA has not paid rent on the carports since the structures were built in 1993. According to the Land Division Administrator, SIBA "wants" to start paying fair market rent for the rest of the parcel so they can use it for parking; however, during our field inspection of the site, we observed that SIBA is already using the parcel for parking. We noted as many as 70 cars, delivery vans, and a variety of trucks parked throughout the Commercial Center lot. In addition, one corner of the parcel contained several junked vehicles in various stages of disrepair.

A 2015 appraisal calculated that the annual fair-market rent for the Commercial Center parcel for 2015 was $199,200 and would increase incrementally to $211,300 in 2017, $284,000 in 2027, $381,700 in 2037, and eventually to $513,000 in 2047. It is unclear how long SIBA has been using the area as a parking lot; however, what is clear is that the decision on when to start paying for its additional use of the property is the Land Division's – not SIBA's – to make. And, since 2015, the division has known exactly how much to charge for that use.

Lease Extensions: The Land Division did not exercise due diligence in verifying lease extension requirements.

Pursuant to Act 207, SLH 2011, lessees that were granted 10-year extensions were required to provide receipts and other documentation of improvements or lease extensions would be canceled. Of the 13 lease files we reviewed, only 4 contained all the receipts necessary to verify that the lessee completed the required improvements. Some files only included proposals submitted by contractors. Others included receipts for only a portion of the improvement costs.

During our review of these lease extensions, we found the Land Division staff was not ensuring the lessees were complying with the statutory requirements. There is also a question as to whether some of the "substantial improvements" proposed by the lessees were instead routine repairs and maintenance. For example, roof and gutter repairs (versus replacement); roof resurfacing; replacement of skylights, gutters, and deteriorated sections of building; painting; and repairing termite damage were deemed substantial improvements in some cases. We also found one case where the lessee's substantial improvements included replacement of a fuel distribution pump, which is business equipment and not a building improvement. In a few cases, the lessees were given credit for improvements made in years prior to the extension request.

In addition, some proposed improvements would not normally require a full 10-year extension period to amortize the costs of those improvements. Several leases contained relatively small amounts ranging from almost $30,000 to as little as $12,000. However, the Land Division Administrator pointed out that at the time the statutes did not define "substantial improvements." He also noted that the Hawai'i District Office has limited staffing and had to deal with 50-plus leases all coming in for extensions at the same time. They were trying hard to meet their deadlines and might have done a more thorough job given more time. The Land Division Administrator recalled that these issues were addressed in the Land Board submittals and that the Land Board could have rejected the extension if they suspected something was wrong.

The Land Division has a public trust obligation to ensure lease extensions are handled properly and in accordance with the statutes. Adequately fulfilling these duties will avoid any perception that even modest extensions of administrative latitude might conceivably be abused, or that special privileges are being afforded to private lessees at the expense of the State.

While the Land Division Administrator argued that Chapter 171, HRS, provides all the guidance staff require, support for this assertion is

unclear. According to the Assistant Land Division Administrator, there are no policies, procedures, or guidance for staff to evaluate substantial improvements versus repairs and maintenance; the time period necessary to amortize the costs of the substantial improvements; and giving the lessee credit for improvements made prior to the extension request. He also noted that there are no policies, procedures, or guidance in place for staff to document and review completion of the promised substantial improvements and verification of the required receipts.

DLNR commissioned a study analyzing the market conditions in Hilo and KIA areas two years after the Land Board started extending the area's leases.

In late 2014, DLNR commissioned an urban planning and project management consultant to assess the market conditions for industrial properties in the Hilo and KIA areas and analyze future demand for industrial, commercial, and mixed industrial-commercial uses on these lands in the short- and long-term. According to the study, "With the approaching expiration of these leases, DLNR has commissioned several studies for the KIA to support long-term planning efforts for the area."

The objectives of this study were to:

- Determine the market demand for KIA properties, particularly the demand for commercial/industrial use or some other use for long-term leasing (30 years or more).

- Determine whether some properties should be consolidated and reconfigured to maximize the utility of the land in view of the results from the above findings.

- Assess the feasibility and desirability of placing management of the leasehold properties under a master lease from the State for commercial, industrial, or other uses permitted by the applicable zoning.

The consultant's report concluded that, if DLNR wishes to retain businesses on its properties in the long term, investment in redevelopment, consolidation, and infrastructure upgrades should be considered. The reissuance of leases (i.e., new leases) would create opportunities and incentives for new investment in the area and strengthen KIA's competitive position among industrial parks in East Hawai‘i. These conclusions are similar to the general recommendations the Land Division made to the Land Board during KIA lease extension discussions in 2012.

It is unclear why DLNR commissioned the study when it did. It was either too late or too early, since by the time it was published in June 2015, 11 of the 70 KIA leases had already been extended by the Land Board for an additional 10 years. In either case, the Land Division did not – and still does not – have a long-range plan for land management, so the study's findings and conclusions have little value.

Gravy Train

KIA tenant-turned-landlord profits from a flawed lease and the Land Division's limited capabilities.

IN SEPTEMBER 2012, Land Board members had a lengthy discussion about 69 Railroad, LLC, a KIA lessee with a 4.5-acre lot who was collecting four times more rent from its tenants than it was paying to lease the state-owned land. At the time, 69 Railroad, LLC received approximately $300,000 in sublease income annually, compared to the $74,500 a year it paid DLNR for the same property. When the lessee sought Land Board approval for two subleases on September 28, 2012, the Land Division asked for a 33 percent share of the sublease rent, noting that 69 Railroad, LLC did not operate an industrial business at the site and was only a landlord. However, the original lease had fixed rents through March 5, 2016, and did not include a provision that would allow the State to share in the sublease income. After objections from 69 Railroad, LLC's property manager and attorney, the Land Board approved the two subleases, but rejected the Land Division's recommendation to take a share of the sublease income.

The 69 Railroad, LLC lease was brought before the Land Board again on September 27, 2013, with a recommendation for a 10-year extension. The extension was approved based on the lessee's commitment to self-finance $165,000 in improvements, including major repairs to a warehouse roof and renovations to an adjacent building. A subsequent appraisal to determine 69 Railroad, LLC's rent for the additional 10 years drew a challenge from the lessee. After mediation, the parties agreed to an annual rent of $127,384, according to a Land Board submittal dated January 22, 2015. Although the agreed-upon rent was more than the prior rent, the lessee was still "paid" by DLNR nearly $180,000 to "manage" the property.

Asked whether the Land Board carried out its fiduciary duties in this case, a Land Board member responded that the Land Division does not have the staff resources to become the property manager. As the property manager, the State would have to take care of repairs and maintenance, as well as find new tenants if a tenant moves out.

"In those types of situations, you have to look at the whole picture," he said.

The Land Division did not consider adding a premium to KIA lease extensions.

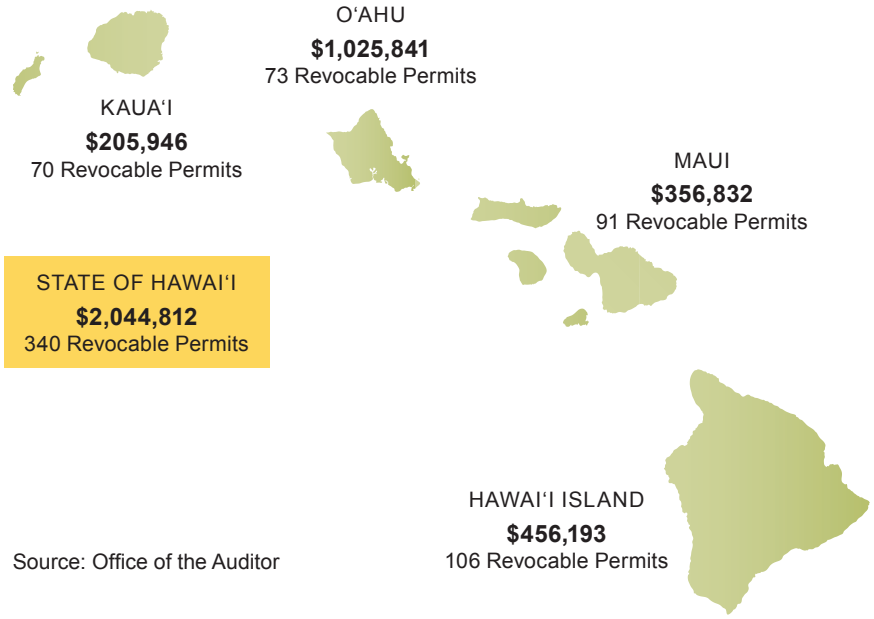
Marketing Practices for Lease Extension is a 2015 consulting report commissioned by DLNR's Division of Boating and Ocean Recreation (DOBOR) to study the private-sector market practices for ground lease extensions. According to this study, private-sector lease extension practices include charging a premium for extending ground leases in exchange for forgoing reversionary interests (i.e., ownership of improvements at the end of the lease term). Since the lessor is giving up flexibility in future use of the property, it can expect to be compensated. However, the Land Division did not consider adding a premium to KIA lease extension rents, as it believed the Land Board would not approve such an increase, nor did it consult with the Attorney General, which considering its interpretation of the public trust doctrine (See the "Public Trust vs. Good Tenants" on page 9), would have likely advised including a premium in the KIA lease extensions.

According to the Land Board Chair, none of the statutory provisions or legislative acts on lease extensions have required a lessee to pay the State for deferral of the State's reversionary interest in the improvements. In order for the Land Board to charge lessees for deferral of the reversionary interest, DLNR and the Land Board believe a statutory basis to seek such compensation ought to be in place, similar to premiums and additional rent provided for in Section 171-36, HRS, when consenting to assignments and subleasing. However, we are unaware of any attempt by DLNR to seek legislation to address the situation; instead, DLNR appears comfortable with the status quo, which benefits the lessees at the State's expense.

The Land Division's inconsistent management of its revocable permits is not serving the public trust.

DLNR issues revocable permits (RP) for the temporary occupancy of public lands. These RPs are meant to be temporary, issued on a month-to-month basis for a period not to exceed one year, which the Land Board could extend for additional one-year periods. We found the clear majority of RPs are decades old and rent adjustments have been few and far between. While the Land Division collected $2 million in revenue from approximately 340 RPs in 2016 (Exhibit 3 below) – 10 percent of the Land Division's total revenue base – charging fair market rents could increase this revenue by nearly 63 percent. Appraisals conducted in 2017 by a firm contracted by the Land Division determined that RP annual rents for those select properties were $838,000 below market values.

Exhibit 3
Revenue from Revocable Permits by Island

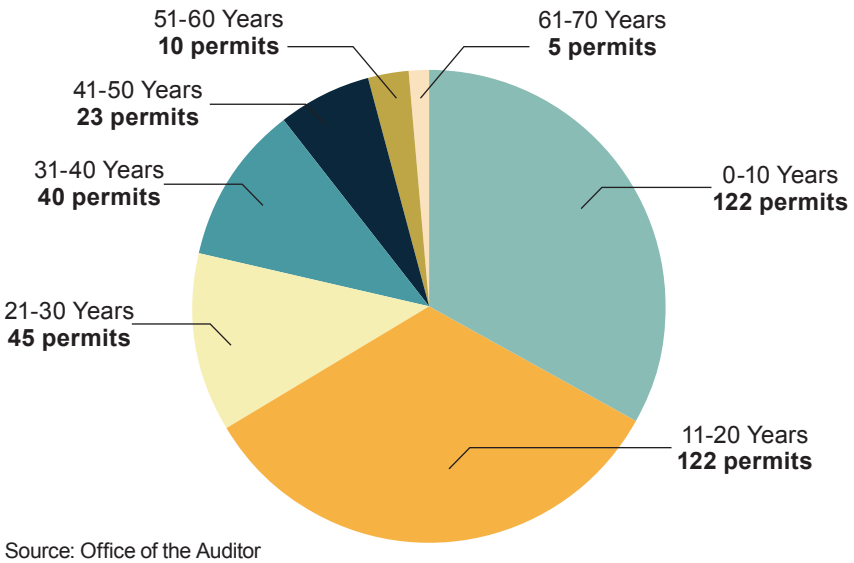


Source: Office of the Auditor

The clear majority of temporary revocable permits are decades old.

We obtained the database of all 367 Land Division RPs as of June 30, 2017, to determine how long they have been in existence. Our analysis as reported in Exhibit 4 (below) found most RPs are decades old. The 11 oldest RPs are between 56 and 67 years old.

Exhibit 4
FY2017 Number of Revocable Permits by Age Group



Source: Office of the Auditor

The Land Division Administrator stated that RPs have not been a priority for the Land Division, and secondary to the management of leases. However, because the RP program has become a major concern of the Land Board, the Land Division has prioritized the conversion of long-held permits to leases. In addition, for nonprofit organizations seeking discounted rents, the Land Division will look more closely at the benefit the organization provides to the community before recommending the appropriate disposition.

However, by allowing RP holders to continue to retain permits for periods well over what could reasonably be construed as "temporary," the State is allowing a number of tenants to continue using thousands of acres of public land, some at less than market rates.

In 2015, Na Moku Aupuni O Koʻolau Hui filed suit against the Land Board and Alexander & Baldwin, Inc. (A&B) regarding its use of month-to-month revocable permits for long-term dispositions of water rights. A circuit court ruled that "A&B's continuously uninterrupted use of these public lands on a holdover basis for the last 13 years is not temporary." The court further stated that "[s]uch a prospect is inconsistent with the public interest and legislative intent." The decision is currently on appeal, and the revocable permits have remained in holdover status.

In 2016, the Legislature amended Section 171-58, HRS, to provide that where an application for a lease to a previously authorized disposition of water rights is pending, a holdover may be authorized annually until either the application is finally resolved, or for a total of three consecutive one-year holdovers, whichever occurs sooner; provided that the total period of the holdover for any applicant shall not exceed three years. Pursuant to Section 171-58, HRS, the Land Board authorized one-year holdovers in 2016, 2017, and 2018. A&B anticipates final publication of its Environmental Impact Statement to be provided to DLNR by the end of 2019, enabling the lease process to be initiated.

Leftover Lands

ACCORDING TO the Land Board Chair, a large portion of the non-conservation lands are set aside for other government agencies, for example, the Departments of Agriculture, Transportation, Education, Accounting & General Services, University of Hawai'i, and the counties. Consequently, DLNR is stuck with the "junk" land, which the Land Division Administrator described as leftover lands, with RP parcels as mainly "leftovers of the leftovers" that cannot be leased. The Land Division Administrator further asserted that many of the older RPs are renewed primarily for upkeep and maintenance, not for revenue generation. If a tenant were to vacate a parcel, the State would not only be responsible for maintaining the property, it would also have to assume liability for it.

RP rent adjustments have been few and far between.

According to the Land Division Administrator, the Land Division has not made many RP rent adjustments, but noted that rent increases could lead to canceled permits, potentially forcing the State to expend resources on parcels for upkeep and maintenance. However, by allowing permit holders to continue to hold RPs for periods well over what could be reasonably construed as "temporary," the State is allowing a number of tenants to continue using thousands of acres of state land, some at less than market rents. We reviewed a sample of 113 RP files (out of approximately 350 RPs) as of June 30, 2017: 31 on Oʻahu, 29 on Hawaiʻi Island, 30 on Kauaʻi, and 23 on Maui.

The ages of these RPs ranged from 1 to 51 years. Out of our sample, only 5 of the 113 RPs have had rent increases since their inception.

On April 22, 2005, the Land Board adopted a Land Division proposal to review rents for baseyard/storage, commercial, and industrial RPs on an annual basis. Rents for other RPs were to be reviewed at 5- or 10-year intervals. The reviews were to be conducted by the Land Division staff appraiser utilizing a review of market indices, interviews, and research. However, the Land Division has been without the services of a staff appraiser since June 2011, and as a result, the Land Division was unable to make recommendations to the Land Board as to fair market rents. The Land Division's submittal also noted that, in January 2001, the Land Board approved a Land Division proposal to review and appraise at least 10 percent of existing RPs on each island starting in May 2001. However, mainly due to a lack of appraisal staff, this was not done, and RP adjustments have not been made since 1999.

The Land Division Administrator stated that there have been rent adjustments, although not many. He acknowledged that even when the Land Division had licensed appraisers on staff, they were only doing valuations based on research of the market and comparables. These in-house valuations were not appraisals that adhered to the Uniform Standards of Professional Appraisal Practice. Currently, Land Division staff continues to perform the same type of valuations based on the market and comparables.

2018 CBRE, Inc. appraisals confirmed that RP rents were far below market.

In 2016, the Land Division contracted CBRE, Inc. (CBRE) to determine the value and annual fair market rent for 113 of its approximately 340 RPs. The properties appraised (40 on Hawaiʻi Island, 15 on Maui, 23 on Kauaʻi, and 35 on Oʻahu) encompass various unimproved and improved parcels that are zoned for business, residential, industrial,

PHOTO: ISTOCK.COM

A Peerless Pier

The temporary permit for the Hilton Hawaiian Village Pier, in existence for over 54 years, may be too valuable to convert to a long-term lease.

THE REVOCABLE PERMIT for the Hilton Hawaiian Village pier at Duke Kahanamoku Beach in Waikīkī was issued by DLNR on September 1, 1964, and is the highest income-generating revocable permit in the Land Division's inventory. In 2018, the rent for the 0.09 acre submerged lands was $38,830.90 per month ($465,970 annually), or $1.50 per passenger of any commercial operator using the pier, whichever is greater.

Over the years, there have been several attempts to convert the RP to a long-term easement. Most recently on February 24, 2017, the Land Board heard a request to grant a 55-year, non-exclusive easement to the Hilton Hawaiian Village LLC (Hilton) for pier purposes. Two Land Board members questioned whether the easement should be put out to public auction rather than being directly issued to the Hilton. One Board member also disputed the Land Division's position that the State did not own the pier. The request to grant an easement was deferred pending resolution of these issues.

On October 27, 2017, the Land Division informed the Land Board that in order for the State to issue either an auction or direct easement for both the submerged lands and the pier improvements, the State would need clear title to ownership of the pier. An advising Deputy Attorney General told the Land Board that he was unable to determine who owns the pier. Consequently, the Land Board approved the Land Division's recommendation to continue the Hilton RP on a month-to-month basis for another one-year period through December 31, 2018.

According to the Land Division Administrator, an executive decision was made at the Land Board Chair's Office to keep the Hilton pier as an RP. He said conversion to a long-term disposition would need to be as an easement, not a lease, since it is situated on submerged lands. This would require an appraisal because the pier is classified as submerged lands, which would likely include a 50 percent discount.

According to the Land Division Administrator, when these various discounts are factored in, the conversion could result in a lower valuation of the pier and less rent paid to the State. As for the Hilton, it is agreeable to the $465,970 it pays annually.

Temporary – year after year.

ALTHOUGH THE LAW states that permits shall not exceed one year from the date of issuance, it also includes a provision that allows for additional one-year periods. By allowing one-year extensions of permits without clarifying or narrowing the circumstances under which such extensions are granted, the statute gives DLNR leeway to extend these "temporary" permits for many years in some cases, or even decades in others.

agricultural, and preservation uses. In its analysis, CBRE examined the sales or rents of similar, recently sold or leased parcels to derive the most probable sales price (or value) or the fair market rent of the property being appraised.

In our review of CBRE's four appraisal reports (one for each district), released in January 2018, we found that, for the vast majority of the RPs appraised, the Land Division's rents were below fair market rates, some significantly lower. For example, in 2017, a tenant paid $1,319.47 per year or $21.56 per acre for a 61.2 acre agricultural property on Kaua'i. However, CBRE compared the parcel with other leases to tenant farmers on Kaua'i and O'ahu and concluded that the RP's annual fair market rent should be $225 per acre per year or $13,770 per year, a difference of over 1,000 percent. In another example, a tenant paid about $231,300 per year for a 45-acre parcel for use as a concrete plant on Hawai'i Island. CBRE did a direct comparison with three comparable industrial-zoned properties on the island and concluded that the annual 2018 fair market rent for the parcel was $506,250, a 219 percent difference.

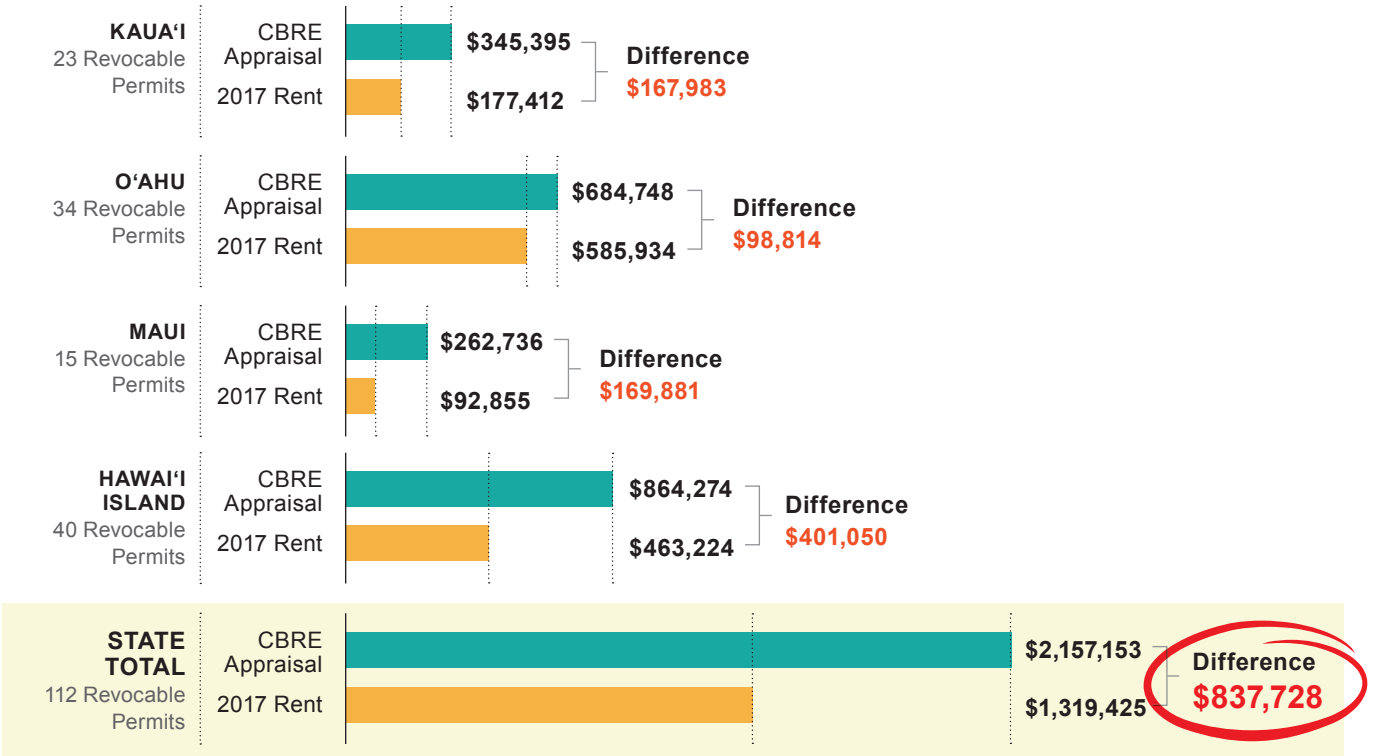
CBRE also found that the 2017 rents for 14 RPs exceeded fair market rents: seven parcels on O'ahu, three on Maui, and two each on Kaua'i and Hawai'i Island for a total of about $107,000 in overcharges. However, overall, the Land Division's rents lagged far behind what CBRE determined to be the market rate: $1.3 million compared to $2.2 million, a difference of nearly $838,000. We note that this considerable sum is reflective of one year's rent from just about a third of the division's 340 RPs.

As a result of CBRE's findings, in Fall 2018, the Land Division sought approval from the Land Board to increase RP rents for 2019. Rents for RPs that were not appraised by CBRE were increased 3 percent over 2018 rents. The rents for the 14 overvalued RPs were recalculated to include the 2018 fair market rent plus 3 percent increases for 2019. Also receiving 3 percent increases were RPs with rents that CBRE determined were less than 10 percent below market rate. However, for RPs with rents that CBRE found to be well below fair market rates (10 percent or more), the Land Division capped rent adjustment to a maximum of 10 percent a year. Without that cap, some tenants would have faced substantial rent increases, which division staff believed would result in lessees cancelling their permits. According to staff, such cancellations would not only mean a loss of revenue, but could result in the division having to maintain the properties itself, a drain on its resources.

While we recognize the division's concerns about possible adverse impacts resulting from substantial rent increases, we question the prudence of such an across-the-board action. We note that, for many

of these RPs, the difference between current and fair market rent is so substantial that it would be unlikely that 10 percent annual increases would close that gap anytime in the near or distant future. In addition, as we pointed out in the previous section, the Land Division has a poor record of increasing tenant rent.

Exhibit 5
Market Rents Compared to Current Rents for FY2017



*Although CBRE appraised 113 RPs, we excluded RP7560 Mount Wilson FM Broadcasters from our analysis because CBRE noted a discrepancy in rents between 2007 and 2017 that may be attributed to the State's Sublease Participation Policy.

Source: Office of the Auditor

The Land Division has recently applied retroactive Consumer Price Index increases to permit holders, following Division of Boating and Ocean Recreation's lead.

Other divisions within DLNR also issue revocable permits, including DOBOR. In 2015, the Land Board approved DOBOR's annual RP renewal request and a recommendation to apply retroactive Consumer Price Index (CPI) increases for the period of July 1, 2015, to June 30, 2016. On December 11, 2015, the Land Division sought continuance for about 340 RPs in a bulk board submittal, with no increase in rent. The Land Division's recommendation regarding RP rent adjustments was to approve no immediate change in current monthly rent for revocable permits, provided, however, that the Land Board reserves and delegates to the Chairperson the right at any time to review and reestablish new rental charges for revocable permits to reflect market conditions or the fair market rent for the rights and privileges granted by such revocable permits and to best serve the interests of the State.

In August 2016, the Land Division followed DOBOR's lead in asking the Land Board to approve interim rate increases for all RPs based on the CPI until independent appraisals could be conducted. The Land Division noted the average annual increase in the CPI for Honolulu from 1999 to 2016 was 2.52 percent, however, in the interest of fairness, a 1.5 percent annual increase was applied to the Land Division's RP renewals in 2017.

Lack of complete and coherent policies and procedures prevents the Land Division from adequately managing its leases and revocable permits.

Chapter 171, HRS, sets forth a general framework for the management and disposition of state-owned lands, including numerous provisions that cover DLNR's wide scope of responsibility. The Land Division Administrator believes Chapter 171, HRS, is comprehensive and provides all the guidance the Land Division needs to manage its lands. Referring to the nearly 90-page chapter as the Land Division's "bible," the Land Division Administrator added that not every agency has such a detailed statutory scheme as Chapter 171, HRS, and the Land Division does not deviate from it.

However, as comprehensive and detailed as Chapter 171, HRS, may be, statutes generally provide only the skeleton, or superstructure, from which to build and implement a state program; agencies need to "fill in the details" to implement the program consistent with the Legislature's intent. When we asked where the Land Division staff can find details and direction on day-to-day operations, the division provided us with its *Policies & Procedures Manual*, a 318-page document last revised on January 21, 2005. The processes included in the manual purportedly cover such tasks as acquisition and disposition of land, lease administration, land maintenance, appraisals, and records management. However, the manual only supports 28 of its 78 processes with narratives, flowcharts, templates, checklists, and other materials staff can refer to for guidance.

We asked the Land Division Administrator to identify where staff can find details and guidance on the 50 processes not supported in the manual; for 41 of those missing items, the administrator referred us to a set of four binders containing processes documented and compiled in December 1998 by certified public accounting firm KPMG LLP (KPMG). However, the binders were not intended to serve as a reference for staff seeking guidance on policies and procedures, and it is unrealistic and unreasonable to expect them to navigate through the 1,600-page collection of disparate documents. As KPMG states in the compilation's conclusion: "The 'AS IS' documentation provides the Division staff with a solid foundation of the current processes occurring day to day and identifies the many processing differences among the districts." According to KPMG, the documented processes were intended to serve as the foundation for reengineering workshops in January 1999, and therefore were prepared for use at the beginning of a reorganization effort, not the endpoint. Furthermore, KPMG compiled these processes before DLNR implemented its current land management information system, which presumably automated some of these tasks.

An outdated and cumbersome property information management system

THE STATE LAND Information Management System (SLIMS) is DLNR's primary tool for managing its properties, including its leases, permits, and other land agreements. Since 2000, DLNR has used SLIMS to monitor lessees' payment of rent as well as lessees' compliance with other lease terms, such as providing proof of insurance and obtaining performance bonds. SLIMS also tracks payments to the Office of Hawaiian Affairs for its share of the revenues derived from ceded lands. (See "What Are Ceded Lands?" and "Superseding the Legislature?" on page 38 and 39 for further explanation on this requirement.)

When we queried the Land Division's four land agents about their sources for policies and procedures, only one of them made even a passing reference to the KPMG document. With land agents on four different islands, it is especially important to have written procedures, as well as clear, consistent administration.

The Land Division does not adequately perform two of its four core lease management functions.

According to the Assistant Land Administrator, the Land Division's main duties for lease management are to: (1) collect rent; (2) ensure adequate insurance is maintained by lessee; (3) ensure the bond is maintained (if needed); and (4) perform field inspections to ensure compliance with what the lessee was approved for and had intended on doing with the land. Our evaluation, combined with the tasks performed by KKDLY, included a review of the processes related to the management of leases and the accounting and reporting related to rent collection. We found the Land Division does not adequately perform two of these four lease management functions. The monitoring and maintenance of lessees' insurance and bond requirements are largely automated functions, and we found no irregularities in these activities; however, KKDLY found that the Land Division lacks clear and coherent policies and procedures for monitoring rent collection. They also found that the division does not have capacity to track delinquent accounts beyond 60 days. We found the Land Division does not conduct annual field inspections to ensure that lessees are complying with their lease terms, a deficiency that has significantly affected the Land Division's ability to manage its land portfolio.

We contracted with KKDLY to assess the general information technology controls and the reliability of SLIMS, one of several tasks in its scope of work. KKDLY found that due to the limitations of SLIMS report writing and functional capabilities, many of these reports require time consuming, manual manipulation of data extracted from SLIMS. To prepare reports for rent delinquencies, accounts receivable, rent reopening, lease expiration, percentage rent, inspection, and liability insurance, DLNR staff must export data from SLIMS to Microsoft Excel. Depending on the report, staff then must insert additional information and remove unnecessary columns and rows before they can perform calculations and allocations. For example, the accounts receivable aging reports generated from SLIMS exclude the names of account holders, which DLNR personnel have to manually insert. However, the aging reports did include numerous accounts with no balances due and numerous subtotals by varying categories (active, suspended, division, island). Staff must manually eliminate the unnecessary rows in order to condense the reports from 3,500 rows to a more manageable 2,200, which enables them to organize the aging

information by account name, number, and balance due by age. Staff have a 12-page document with detailed instructions to help them prepare monthly reports.

KKDLY also found that SLIMS is unable to generate reports with sufficient aging information to effectively monitor and collect delinquent accounts receivable balances. Specifically, SLIMS does not provide sufficient detail for accounts receivable that are more than 60 days old. For example, at the end of June 2017, accounts receivable for DLNR amounted to $7.3 million, with $2.1 million, or 29 percent of the total balance, over 60 days old. According to KKDLY, the department determined $1.6 million of these delinquent accounts receivable (75 percent) were uncollectible due to a history of nonpayment, bankruptcy, or the tenant being out of business. In May 2017, DLNR awarded a contract for an enhanced version of SLIMS. The new system was scheduled to go online for parallel testing in February 2019. DLNR's target "go-live" date is July 2019.

In FY2017, $1.6 million, or 22 percent, of DLNR's accounts receivable were classified as uncollectible.

The Land Division does not conduct annual inspections.

Land leases issued by DLNR include provisions for periodic inspections of leased property to ensure that lessees are adequately maintaining the improvements on the properties. Inspections also ensure, among other things, that the property is being used for the purpose for which it was originally leased, that no unauthorized activities are taking place on the property, that no unapproved subleasing is occurring, and that improvements are being maintained. However, we found that lease and revocable permit inspections have been infrequent.

With more than 1,300 leases and 340 revocable permits in inventory, records provided by the Land Division indicated that inspections were only conducted for an average of 40 revocable permits and 43 leases each year between 2015 and 2017.

The Hawai‘i District conducted the highest number of inspections. According to the Hawai‘i District land agent, there is no official Land Division policy on how or when inspections should be done. He implemented an informal policy for his district requiring inspections to be conducted whenever there is a disposition, i.e., an assignment of lease, rent reopening, etc. He also created a three-page template for his land agents to use when conducting inspections.

The other district land agents were not aware of any formal written policy requiring annual inspections. Both the Land Administrator and Assistant Land Administrator stated that there is an unwritten goal to conduct biennial inspections; however, all four district land agents told

us that with limited staff resources, annual inspections of all leases and revocable permits was not possible.

The Land Division Policies & Procedures Manual requires land agents to conduct close-out inspections as part of the lease termination process; however, we reviewed the files for five leases that were terminated between 2015 and 2017 and found that a close-out inspection was not conducted for all five leases. Close-out inspections should be conducted to look for issues such as hazardous materials, which the State may be liable for upon termination of the lease, as well as any unauthorized dismantling or removal of property that should revert to the State. Close-out inspections also help to ensure that lessees or sub-lessees vacate public land when a lease or revocable permit is terminated.

According to Kaua‘i and O‘ahu land agents, inspections are conducted when a district becomes aware of health and safety issues, or when following up on complaints or other problems brought to their attention. One land agent said the limited staffing means they are "reactive rather than proactive."

Lack of transparency and accountability hinders the administration of the Special Land and Development Fund.

A special fund, like the SLDF, is created by the Legislature to hold and account for revenues that are earmarked for a particular purpose and can only be expended for that purpose. One requirement for a special fund is a clear nexus between the program it supports and the source of its revenues; another is that the special fund must be financially "self-sustaining" as special funds do not receive general fund appropriations. As a consequence, special funds are far less transparent; they are removed from the Legislature's normal budget and appropriation process. However, the Legislature does require DLNR and all other state departments to annually report their non-general funds. That annual report is intended to provide the Legislature with important fiscal information, including revenues, expenditures, transfers, and fund balances as well as estimates of future fiscal years.

In summary, our office and KKDLY found DLNR does not accurately account for the moneys in the SLDF (see Exhibit 6). We determined that DLNR underreported the fund's cash balances to the 2018 Legislature by more than $1.5 million (see Exhibit 9). We also found that more than $1.5 million held in the SLDF has been sitting idle for at least the past five years.[1]

KKDLY performed additional work to assess DLNR's administration of the SLDF from FY2015 to FY2017. KKDLY found that DLNR did not reconcile cash receipts recorded in SLIMS with the State's financial accounting system, that DLNR has no documented controls to ensure it is collecting the percentage rent due under lease agreements, and that over 50 percent of ceded land revenues have been retained and used by the Land Division. KKDLY also determined that the East-West Center did not comply with the World Conservation Congress procurement policies in its use of SLDF moneys to support the International Union for Conservation of Nature (IUCN).

[1] In December 2018, we reported on DLNR's special funds, revolving funds, trust funds, and trust accounts, including the SLDF. See *Review of Special Funds, Revolving Funds, Trust Funds, and Trust Accounts of the Department of Land and Natural Resources*, Report No. 18-19 (December 2018). In that report, we state the financial and other information provided to us by DLNR for the fiscal years 2014 through 2018. We have included certain of the information about the SLDF from our December 2018 report.

DLNR did not accurately account for the amount of moneys in the SLDF.

DLNR reported that the SLDF is comprised of only two accounts, S-316 (Special Land and Development Fund) and S-318 (Maintenance of Public Lands). However, our office and KKDLY found that those two accounts did not accurately account for all the SLDF's revenues, expenditures, transfers, and available cash balances. According to DLNR, account S-316 (Special Land and Development Fund) is the SLDF's "parent" account and the source of revenue for 24 sub-accounts, one of which is S-318 (Maintenance of Public Lands). For purposes of this report, we hereinafter refer to the parent account and sub-accounts, collectively, as the "SLDF accounts." Exhibit 6 represents all the accounts that comprise the SLDF.

Exhibit 6
SLDF Accounts

S-316 – Special Land and Development Fund (parent account)
S-303 – Water and Land Development (sub-account)
S-306 – Nā Ala Hele Program (sub-account)
S-308 – LNR Natural and Physical Environment (sub-account)
S-318 – Maintenance of Public Lands (sub-account)
S-323 – Prevention of Natural Disasters (sub-account)
S-337 – Special Land Development Fund Escrow Account (sub-account)
S-338 – Industrial Park Special Fund Escrow Account (sub-account)
S-353 – Division of Forestry and Wildlife – SLDF (sub-account)
S-354 – Commission on Water Resource – SLDF (sub-account)
S-355 – State Parks – SLDF (sub-account)
S-356 – Hawaii Association of Conservation Districts[1] (sub-account)
S-370 – Flood Study for Mākaha Valley (sub-account)
S-371 – International Union for Conservation of Nature – SLDF (sub-account)
S-400 – Diamond Head State Monument, Oʻahu – Land (S-99-400) (sub-account)
S-400 – DLNR Hazardous Waste Management Plan, SW – Plan (S-03-400) (sub-account)
S-401 – Plan for the Development of Public Lands SW – Plan (sub-account)
S-403 – Old Puʻunui Quarry Site Rockfall Oʻahu - Design (sub-account)
S-404 – Acquisition of Land in Waiomao, Pālolo, Oʻahu – Plan (sub-account)
S-405 – Acquisition of Land in Waiomao, Pālolo, Oʻahu – Design (sub-account)
S-406 – Acquisition of Land in Waiomao, Pālolo, Oʻahu – Construction (sub-account)
S-407 – Acquisition of Land in Waiomao, Pālolo, Oʻahu – Land (sub-account)
S-410 – Kawai Nui Marsh Maintenance Baseyard, Oʻahu – Design (sub-account)
S-411 – Kawai Nui Marsh Maintenance Baseyard, Oʻahu – Construction (sub-account)
S-412 – Moanalua Stream Dredging, Oʻahu – Design (sub-account)

[1] Account S-356 (Hawaiʻi Association of Conservation Districts) was created during FY 2018.

Source: Office of the Auditor and KKDLY LLC

The 25 accounts are all special fund accounts, which were created within the SLDF to track and manage moneys that are earmarked or set aside for a specific program or purpose. A department must know all the accounts, including sub-accounts, within a special fund to accurately track expenditures from the fund to ensure that those expenditures are consistent with the purposes for which the special fund was created. It is improper for a department to use special fund revenues for other purposes.

The department reported to KKDLY transfers of funds out of the SLDF's parent account, S-316, to its sub-accounts for each fiscal year from 2015 through 2017. Transfers record the movement of funds from an account into another DLNR account or into an account maintained by another department. Once transferred, those moneys are no longer accounted for and reported as part of the account from which they originated; instead, those funds are accounted for and reported as part of the account into which they were transferred.

Because DLNR identified only two accounts, S-316 and S-318, for the SLDF, the transfers it reported appeared to be to accounts outside of the SLDF, which accordingly seemed to reduce the SLDF's cash balance (or available moneys). However, KKDLY found that these transfers actually represented transfers of funds to SLDF sub-accounts (see Exhibit 7), meaning that the moneys were still part of the SLDF, but were excluded by the department when it reported the SLDF's cash balance to KKDLY. For example, rent from leases of public lands is deposited into the SLDF parent account, S-316, and subsequently transferred to a SLDF sub-account that supports the Division of Forestry and Wildlife, S-353. Because DLNR did not report S-353 as being one of the SLDF sub-accounts, the SLDF's cash balance reflected the transfer out of the SLDF parent account but not the corresponding transfer into the SLDF sub-account, creating the appearance that the SLDF's balance of available cash was reduced by the amount of the transfer.

Exhibit 7
Transfers of Funds Within the SLDF

Transfers In (Out)	FY2015	FY2016	FY2017
S-316 – Special Land and Development Fund (parent)	$ (7,031,242)	$ (4,270,234)	$ (3,977,139)
S-318 – Maintenance of Public Lands (sub-account)	1,078,553	-	370,000
S-303 – Water and Land Development (sub-account)	702,663	709,916	(90,084)
S-306 – Nā Ala Hele Program (sub-account)	250,000	250,000	250,000
S-308 – LNR Natural and Physical Environment (sub-account)	410,736	329,076	435,493
S-323 – Prevention of Natural Disasters (sub-account)	705,290	819,450	839,896
S-353 – Division of Forestry and Wildlife – SLDF (sub-account)	-	955,475	955,475
S-354 – Commission on Water Resource – SLDF (sub-account)	-	622,101	632,143
S-355 – State Parks – SLDF (sub-account)	-	584,216	584,216
S-370 – Flood Study for Mākaha Valley (sub-account)	(16,000)	-	-
S-371 – International Union for Conservation of Nature (sub-account)	3,900,000	-	

Source: KKDLY LLC

In addition, the department transferred over $1.3 million and $2.4 million in FY2015 and FY2017, respectively, from the SLDF to other DLNR special funds, i.e., to accounts that are not part of the SLDF (see Exhibit 8). As noted earlier, under Hawai'i law, special funds must be financially self-sustaining. DLNR should not be transferring SLDF moneys to other special funds. If the revenues in those special funds are insufficient to support the intended program or purpose, the fund should be closed, and the program funded through general funds.

Exhibit 8
Transfers of Funds from the SLDF to other DLNR funds

Transfers Out of S-316	FY2015	FY2016	FY2017
S-312 – State Parks Special Fund	$ 584,216	$ -	$ -
S-326 – Water Resource Management Fund	510,404	-	-
S-347 – Forest Stewardship Fund	250,000	-	-
S-349 – Conservation and Resources Enforcement	-	-	400,000*
S-305 – Park Development and Operations	-		2,000,000*
Total	**$ 1,344,620**		**$2,400,000**

*The transfers consisted of Transient Accommodation Tax (TAT) moneys which were transferred to those accounts pursuant to Act 124 (SLH 2016).

Source: KKDLY LLC

DLNR did not accurately account for and report on the activities of the SLDF to the Legislature.

DLNR, under Section 37-47, HRS, is required to submit to the Legislature a report for each non-general fund account no later than 20 days prior to the convening of each regular legislative session. This report includes, but is not limited to, the name of the fund, the law authorizing the fund, the intended purpose of the fund, the current activities that the fund supports, and the balances in the fund and related revenues, expenditures, encumbrances, and transfers.

However, we found that DLNR did not report 15 of the SLDF sub-accounts on its annual non-general funds report to the Legislature before the 2018 session. And, as a result, the total SLDF balance of available moneys reported by DLNR to the Legislature was understated by over $1.5 million (see Exhibit 9). Because special funds like the SLDF are outside of the normal budget and general fund appropriation process, they offer limited, and often zero, transparency, meaning the Legislature may not know how much money is in a special fund. Annual reporting of departments' non-general funds, as required by Section 37-47, HRS, is the primary means through which the Legislature monitors fund balances and identifies excess moneys for possible transfer to the general fund.

Exhibit 9
SLDF Accounts Not Reported to the 2018 Legislature, Account Balances as of June 30, 2017

S-337 – Special Land Development Fund Escrow Account	$ 0
S-338 – Industrial Park Special Fund Escrow Account	0
S-370 – Flood Study for Makaha Valley	0
S-371 – International Union for Conservation of Nature – SLDF	19,874
S-400 – Diamond Head State Monument, Oʻahu – Land (S-99-400)	440,000
S-400 – DLNR Hazardous Waste Management Plan, SW – Plan (S-03-400)	250,000
S-401 – Plan for the Development of Public Lands SW – Plan	299,685
S-403 – Old Puʻunui Quarry Site Rockfall Oʻahu – Design	768
S-404 – Acquisition of Land in Waiomao, Pālolo, Oʻahu – Plan	10,000
S-405 – Acquisition of Land in Waiomao, Pālolo, Oʻahu – Design	4,899
S-406 – Acquisition of Land in Waiomao, Pālolo, Oʻahu – Construction	154,550
S-407 – Acquisition of Land in Waiomao, Pālolo, Oʻahu – Land	42,366
S-410 – Kawai Nui Marsh Maintenance Baseyard, Oʻahu – Design	5,781
S-411 – Kawai Nui Marsh Maintenance Baseyard, Oʻahu – Construction	282,400
S-412 – Moanalua Stream Dredging, Oʻahu – Design	24,312
Total	**$ 1,534,635**

Source: Office of the Auditor

Auditability of Accounting Records

IN NOVEMBER 2017, at the department's request, we contracted N&K CPAs, Inc. to audit DLNR's financial statements for the fiscal year ended June 30, 2017; however, the auditors were unable to complete the audit by the February 16, 2018 target date because they found significant irregularities in the department's accounting records. In one instance, DLNR's schedule of capital assets differed from what is reported in the State's accounting records by approximately $626.6 million. DLNR subsequently hired a consultant to assist in "cleaning up" the accounting records so that the auditors would be able to complete their work. The clean-up was completed in February 2019 and the audit was completed in April 2019.

The SLDF includes 11 accounts with cash balances aggregating more than $1.5 million that have remained idle for at least 5 years.

DLNR informed us that the "400-series" SLDF accounts were established to fund various capital improvement projects. We found that there has been no activity in any of these accounts since at least 2014, which means the moneys in those accounts have just sat idle for the past five years. It is unclear whether the projects are still planned, have been completed, or were abandoned. As of June 30, 2017, cash balances aggregating more than $1.5 million were held in these 400-series SLDF accounts. The information required by the annual reporting may have allowed the Legislature to consider using those moneys for other priorities.

Cash receipts recorded in SLIMS were not reconciled to FAMIS for the fiscal years ending June 30, 2015 and 2016. The June 30, 2017 reconciliation was not prepared on a regular basis.

As previously noted, we retained consultant KKDLY to perform certain procedures relating to the financial management of the SLDF. These procedures are detailed in Appendix A. KKDLY's findings as a result of their performance of these procedures are set forth in this section.

Cash receipts, consisting primarily of public land lease rents, sale proceeds, fees for licenses and permits, and other fees, are recorded in SLIMS to facilitate DLNR's land management collection activities. The State uses the financial accounting and management information system (FAMIS) to account for all state funds. Cash receipts recorded in SLIMS should be reconciled to deposits recorded in FAMIS to ensure that the transactions are properly recorded in FAMIS. This will also allow DLNR to identify and correct posting errors on a timely basis.

DLNR informed KKDLY that they did not reconcile cash receipts recorded in SLIMS to the deposits recorded in FAMIS for FY2015 and FY2016. DLNR reconciled its SLIMS' data to that maintained in FAMIS for FY2017. However, DLNR did not complete this reconciliation until October 2018, more than 15 months after the close of the fiscal year on June 30, 2017. Several differences were identified during the reconciliation process, including a transfer of Transit Accommodation Tax moneys that was unrecorded in SLIMS and several cash receipts that were posted to incorrect DLNR accounts in FAMIS. Adjusting journal entries were recorded in October 2018 to correct cash receipts recorded in SLIMS and FAMIS.

Procedures for the collection and review of percentage rent received from lessees need improvement.

According to DLNR, there were 27 lease agreements containing percentage rent clauses (rent based on a percentage of the lessee's gross receipts) as of June 30, 2017. DLNR may require sales audits be performed by independent auditors to verify the calculation of percentage rent in accordance with the lease agreement. Otherwise, DLNR relies on self-reported revenues and percentage rent calculations contained in the certified statement of gross receipts submitted by lessees.

KKDLY noted that DLNR does not formally document its review and approval of the certified statement of gross receipts submitted by lessees to indicate that DLNR staff determined the reported revenues were reasonable and that the calculation of percentage rent was in accordance with the lease agreement. The certified statements of gross receipts should identify the DLNR staff who reviewed them and the dates of the review. For practical reasons, the level of review will vary depending on the percentage rent due.

DLNR should establish documented procedures related to the collection of percentage rents due from lessees to provide a clear, consistent timeframe for the receipt of sales audit reports and certified statement of gross receipts for all leases with percentage rent clauses. DLNR should also have procedures to follow if lessees fail to submit required sales audit reports, certified statements of gross receipts, or payment of the required percentage rent.

Revenues from ceded lands have not been transferred to the general fund.

Twenty percent of the revenues DLNR receives from certain leases and permits of ceded lands are required to be transferred to the Office of Hawaiian Affairs (OHA). The remaining 80 percent of those ceded land revenues are held by the State as a public trust for the following purposes: (1) support of public education; (2) betterment of the conditions of Native Hawaiians; (3) development of farm and home ownership; (4) public improvements; and (5) provision of lands for public use.

KKDLY found that from FY2015 through FY2017, DLNR received $47.1 million in revenue from the ceded lands that it manages. In each of those three years, the department remitted to OHA an average of $3.1 million, for a total of $9.4 million, which was 20 percent of the ceded lands revenue, as required by law.

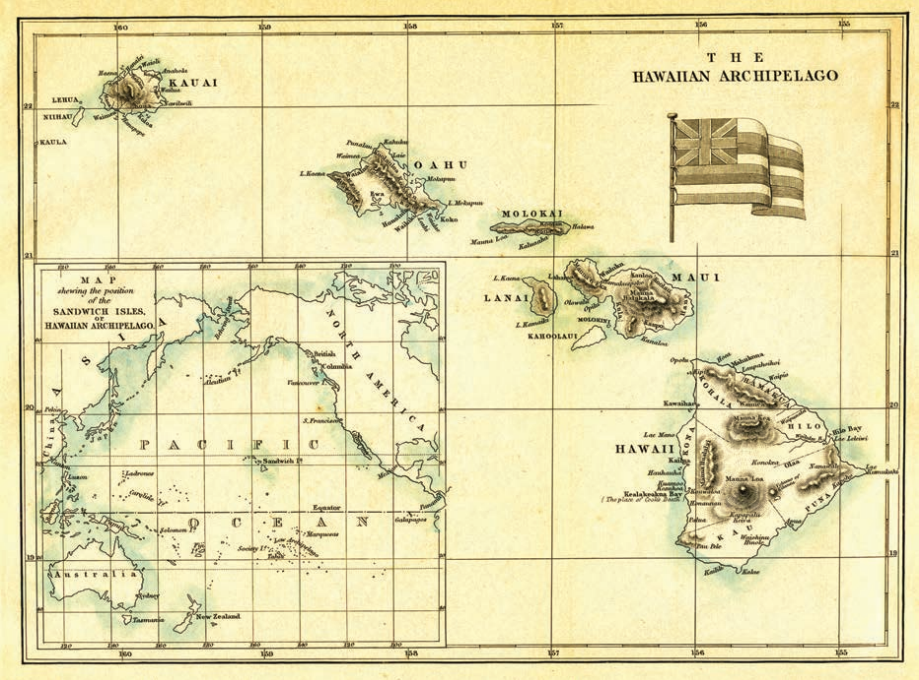


PHOTO: THINKSTOCK.COM

Superseding the Legislature?

Did the Land Board overstep its authority when it designated Land Division properties on ceded lands as "income-producing assets"?

ACCORDING TO the Hawai'i Admission Act, which made Hawai'i a U.S. state in 1959, revenue from ceded lands are to be held by the State as a public trust for the following purposes: (1) support of public education; (2) betterment of the conditions of Native Hawaiians; (3) development of farm and home ownership; (4) public improvements; and (5) provision of lands for public use. In 1979, the Legislature enacted Chapter 10, HRS, which created the Office of Hawaiian Affairs. A year later, the Legislature amended Chapter 10, adding section 10-13.5, HRS, which requires that 20 percent of all revenues from ceded lands be expended by OHA for, among other things, the betterment of conditions of Native Hawaiians.

In a December 1, 2010 submittal to the Land Board, the Land Division Administrator reported that, over the years, after paying its 20 percent to OHA, the 80 percent portion of ceded land revenues was used to "supplement" the general fund. However, in the past several years, according to the Land Division Administrator, a portion of these funds had been used to cover the shortfalls of other agencies' OHA payments. Recently, these agencies had begun to regularly provide their 20 percent to OHA; therefore, he reasoned that the remaining

What are Ceded Lands?

CEDED LANDS are the approximately 1.8 million acres of land that were transferred, or ceded, to the United States at the time of the annexation of Hawai'i in 1898. These lands consisted of crown lands once property of the Hawaiian monarchy, and government lands of the Kingdom of Hawai'i. The Admission Act, which granted statehood to Hawai'i in 1959, returned the lands to the new State of Hawai'i and provided that they be held as a public trust. The Act stated that management and disposition of such lands should be used as called for by the constitution and laws of Hawai'i.

We question the Land Division Administrator's interpretation of the statutory provision that created the SLDF, specifically his belief that the revenues from ceded lands administered by the Land Division (after OHA's 20 percent share) are intended to fund the division and other department programs.

80 percent could now be "returned" to the SLDF. He wrote: "Based on the express language of the SLDF as noted above, the remaining 80% of ceded land revenues (after paying OHA its 20% share) is supposed to be deposited directly into the SLDF and expended by the Department in accordance with HRS 171-19."

The Land Division Administrator recommended that the Land Board designate 88 hotel, resort, commercial, and industrial properties on ceded land as "income-producing assets" and authorize the deposit of the revenues from these properties (minus the 20 percent obligated to OHA) into the SLDF so that they may be "expended for departmental purposes in accordance with HRS 171-19.3."

Eighty of the properties are located on Hawai'i Island, with four on O'ahu and two each on Maui and Kaua'i. In 2010, the total annual lease rent for the properties was $3.6 million, of which $2.9 million (80 percent) would be deposited into the SLDF. Some of the more recognizable properties on the Land Division Administrator's proposed list were the Hilton Hawaiian Village Pier and Olomana Golf Links on O'ahu and the Hilo Hawaiian Hotel on the Big Island.

The Land Board approved the proposal on December 1, 2010. In February 2011, the Land Division proposed amending the board action to add 42 additional properties to the list of income-producing assets. Eight months later, it proposed adding five more properties to the list. The Land Board approved both proposals.

From FY2015 – FY2017, the department deposited approximately $27.2 million (58 percent of total ceded land revenues) into DLNR special fund accounts for use by those DLNR programs and transferred approximately $8.7 million (18 percent) to the general fund.

We question the Land Division Administrator's interpretation of the statutory provision that created the SLDF, specifically his belief that the revenues from ceded lands administered by the Land Division (after OHA's 20 percent share) are intended to fund the division and other DLNR programs. It is unclear that the uses of the SLDF are consistent with the purposes for which ceded land revenues can be used under the Admissions Act. The ceded lands and the revenues therefrom are held by the State as a public land trust and can only be used for the five specific purposes listed in Section 5(f) of the Admissions Act.

We also question whether DLNR is superseding the Legislature's power to decide the appropriate use of ceded lands revenues. The Admissions Act returned to the State approximately 1.8 million acres of land that had been transferred, or ceded, to the United States at the time of annexation of Hawai'i in 1898 and provided the lands be held in a public land trust for one or more of five specific purposes identified in the Act. By keeping the ceded lands revenues (after OHA's 20 percent share) in the SLDF, DLNR – not the Legislature – is deciding the appropriate use of those moneys; DLNR – not the Legislature – has assumed the State's fiduciary responsibility to decide how to use the ceded lands revenues, including uses such as the support of public schools that are clearly outside of the purposes of the SLDF.

We believe significant policy decisions about the use of state funds, including the use of ceded land revenues, are the purview of the Legislature – not an individual agency – and suggest that DLNR seek guidance from the Legislature about whether the department is authorized to keep and spend ceded land revenues without specific Legislative approval to do so.

During the same three-year period, instead of transferring the remaining 80 percent of the ceded lands revenue to the general fund, DLNR set aside only 18 percent ($8.71 million) for the general fund.[2] DLNR transferred 2 percent ($1.2 million) to the County of Hawai'i and retained 58 percent ($27.2 million) of the revenues in the SLDF for use by the department for its programs.

East-West Center did not comply with procurement guidelines.

KKDLY's review of the SLDF moneys used to fund the International Union for Conservation of Nature (IUCN) included reviewing board minutes for the 2016 World Conservation Congress (WCC), identifying all funding sources, and reviewing internal controls over the accounting and reporting of cash disbursements. See Appendix C for expenses by natural classification of the WCC and vendors paid more than $100,00 in the aggregate.

East-West Center served as the fiscal agent to account for the financial activities of the WCC. KKDLY's review of the East-West Center's compliance with the procurement guidelines in accordance with the WCC Spending Policy for the procurement of the selected vendors and employees identified the following instances of noncompliance:

- For two procurement actions, KKDLY was unable to obtain evidence of the IUCN Board's review and approval of the procurement worksheet as required by the WCC Spending Policy. The procurement worksheet identifies the source of funds, the type of procurement method required (i.e., request for proposals, sole source, small purchase, etc.) and other information regarding the scope of work and vendor evaluation factors.

- For four procurement actions, KKDLY was able to obtain evidence of the review of the proposals received. However, KKDLY was unable to determine who performed the review as part of the evaluation panel.

KKDLY requested, but did not receive, documentation for the procurement of Carlsmith Ball LLP (Carlsmith). According to the WCC president, the decision to procure legal services from Carlsmith was made prior to the development of the WCC Spending Policy. The WCC president and the former East-West Center president selected Carlsmith based on the firm's experience serving the Hawai'i Host Committee

[2] In August 2017, at the direction of the State Department of Budget & Finance (B&F), DLNR transferred $26.5 million to the general fund, which represented the State's portion of the ceded lands revenues for FY2008 through FY2016.

for the 2011 Asia Pacific Economic Cooperation (APEC). The WCC president served as chief operating officer for the APEC Hawai‘i Host Committee, while the former East-West Center president served as a member of the APEC Hawai‘i Host Committee.

Conclusion

DLNR's Land Division has the formidable task of generating revenues for the SLDF to support not only its own budgetary needs, but also that of seven other programs and divisions. Thus, increasing SLDF revenues is becoming increasingly vital to DLNR. Another equally important function of the Land Division is the administration of the lands held in public trust.

Under recent legislation regarding public lands, the Land Board and the Land Division have struggled with carrying out their fiduciary responsibilities and conducting operations as a private landowner seeking to increase revenue. Decisions regarding land dispositions have been arbitrary, and the Land Division has not demonstrated that its actions have always been in the best interests of the State.

The Land Division needs to develop a long-range asset management or strategic plan to determine priorities, guide its decisions, and measure the effectiveness of its programs and services. The primary focus should not be on existing program approaches, but instead attention should be given to alternatives that involve major changes, such as those that result from legislative action.

The Land Division must develop and update policies and procedures to fulfill its mission, strategic plan, goals, and objectives. These are internal controls which will help the Land Division to achieve desired results through effective stewardship of public resources. In addition, standardized policies and procedures will ensure consistent and compliant practices.

The Land Division must prepare itself for leases which have been in existence since the 1960s and are set to expire. The Land Division must begin exploring new opportunities to generate higher revenues and train current staff to transition from ground leases to space leases, as well as offer training in property management functions, and enhanced marketing activities.

Recommendations

The Land Board should:

1. Provide training for Land Board members about fiduciary responsibilities and obligations as trustees, including responsibilities related to the management and holding of state lands for the benefit of the State and promoting the development and utilization of public trust lands to their highest economic and social benefits. See In Re Water Use Permit Applications, 94 Haw. 97 (2000).

2. Require DLNR and the Land Division to develop a long-range asset management/strategic plan that provides direction to the department and the Land Division as to the management of all leases, RPs, and public lands managed by the division.

3. Reconsider caps on annual rent adjustments for all rents below fair-market rates. Instead, the Land Board should review rent readjustments on a case-by-case basis.

The Land Division should:

1. Prepare a long-range asset management/strategic plan that includes criteria for assessment based on benchmarks and other measurable objectives. The plan should address all leases, RPs, and public lands managed by the Land Division.

2. Develop and document policies and procedures for:
   a) monitoring of leases and RPs;
   b) periodic and regular reviews of RP rents;
   c) verification of required receipts to validate substantial property improvements required for 10-year lease extensions; and
   d) timely and effective collection of lease and RP rents.

3. Establish guidelines and requirements for periodic and regular inspections of leases and RPs to ensure that lessees are adequately maintaining improvements on the properties. If additional staff is needed to reasonably carry out these duties, a workload analysis should be performed to justify more positions.

4. Perform close-out inspections for leases and RPs upon termination of leases or RPs based on updates to the Land Division guidelines. Inspections should include looking for specific issues such as the presence of hazardous materials, as well as documenting any unauthorized dismantling or removal of property that should revert to the State.

5. Explore strategies to better market and manage its properties, which may include contracting private-sector brokers and property managers. We suggest the division consult with the State Procurement Office and other state agencies, such as the Hawai‘i Public Housing Authority, which contract for similar services. The division should also seek legislative assistance through statutory amendments if necessary, for example, to assess rent premiums when the Land Board decides to extend leases.

6. Seek to hire people with professional expertise or develop and implement a training program to prepare land agents for the transition from ground leases to space leases, perform property management functions, and conduct in-house evaluations whenever external appraisals are not cost-effective.

The Department of Land and Natural Resources should:

1. Establish policies and procedures to accurately account for and report the activities of the SLDF to the Legislature.

2. Review the 400-series special fund accounts to determine whether the unexpended and unencumbered balances remaining in these accounts should be transferred to other SLDF accounts or transferred back to the origination fund. Considering the amount of SLDF cash disbursements and transfers to other DLNR special fund accounts, we further recommend that DLNR review each of the SLDF accounts to ascertain whether these accounts continue to meet the criteria of a special fund. Specifically, there should be a clear link between the programs and the sources of revenue. If not, these accounts should be subject to the State's general fund budget and appropriation process.

3. Reconcile cash receipts recorded in SLIMS to FAMIS on a monthly basis.

4. Determine with the Department of Budget and Finance whether revenues from ceded lands, net of amounts remitted to OHA, should be transferred to the State's general fund on a regular basis.

5. Establish and adhere to formal written procedures for the collection of all percentage rent due from lessees. These procedures should address the timely receipt of sales audit reports or certified statements of gross receipts and percentage rent payments for all leases with percentage rent clauses, as well as appropriate actions to be taken for lessees failing to submit required sales audit reports or certified statement of gross receipts, and if applicable, percentage rent payments. In addition, these procedures should include documentation requirements for DLNR's review and approval of certified statement of gross receipts provided by lessees.

Appendix A
Scope of Work

KKDLY LLC performed the following procedures for the fiscal years ended June 30, 2015, 2016, and 2017:

1. Identified and reported all accounts that comprise the SLDF.

2. Identified and reported all potential revenues and sources of revenues, and reported all revenues credited to the SLDF.

3. Reviewed internal controls over the accounting and reporting of cash receipts (i.e., leases and permits) deposited in the SLDF, including a walk-through of the cash receipts cycle.

4. Reviewed internal controls over the accounting and reporting of cash disbursements from the SLDF, including a walk-through of the cash disbursements cycle.

5. Prepared a schedule of expenditures by cost category. Selected vendors that were paid more than $100,000 in aggregate, and reviewed invoices for proper approval, for compliance with procurement procedures, and for propriety of disbursements.

6. Identified and reported all transfers to and from each account of the SLDF and determined the propriety of such transfers. Prepared a schedule of all accounts with transfers to and from the SLDF and determined whether the transfers served a stated purpose of the SLDF.

7. Prepared a schedule of cash receipts, cash disbursements, transfers, and fund balance for the accounts that comprise the SLDF. Reconciled the schedule to the Department of Accounting and General Services, State of Hawai‘i (DAGS) reports and determined whether DLNR reconciled these accounts to DAGS records.

8. For the International Union for Conservation of Nature (IUCN), reviewed the board minutes for the 2016 World Conservation Congress, identified and reported all funding sources, and reviewed internal controls over the accounting and reporting of cash disbursements.

9. For the IUCN expenditures using monies from the SLDF, identified and reported expenditures by cost category. Selected vendors and employees that were paid more than $100,000 in aggregate and reviewed invoices for proper approval, for compliance with procurement procedures, and for propriety of disbursements.

10. Assessed the general information technology controls and the reliability of the State Land Information Management System (SLIMS) property management software to provide DLNR with an accurate reporting of all leases and permits, rents collected, amounts outstanding by tenant, and reconciliation to the SLDF and DAGS records.

Appendix B

Schedule of Revenues, Expenditures, Transfers, and Fund Balance – Cash Basis for the Fiscal Years Ended June 30, 2015, 2016, and 2017

	2015	2016	2017
Revenues:			
Leases, licenses, permits, and fees	$ 12,176,543	$ 12,242,847	$ 13,290,311
Transient accommodations tax	-	-	2,400,000
Highways fuel tax	238,761	250,000	249,811
Other	219,924	232,162	258,809
Total revenues	12,635,228	12,725,009	16,198,931
Expenditures:			
Personnel	6,698,921	6,867,725	7,252,639
Professional services	1,236,031	2,762,572	3,626,688
Repairs and maintenance	671,274	980,223	568,949
Machinery and equipment	318,788	50,326	301,936
Rental	150,424	160,486	252,325
Supplies	117,168	303,022	251,894
Travel	104,757	112,827	141,368
Insurance	91,177	84,458	107,678
Other	1,246,701	819,954	1,212,178
Total expenditures	10,635,241	12,141,593	13,715,655
Revenues over expenditures	1,999,987	583,416	2,483,276
Net transfers in (out) of SLDF	(127,400)	636,699	(1,834,553)
Net increase in fund balance	1,872,587	1,220,115	648,723
Fund balance at beginning of year	17,983,143	19,855,730	21,075,845
Fund balance at end of year	$ 19,855,730	$ 21,075,845	$ 21,724,568
Encumbrances	$ 5,331,707	$ 6,481,490	$ 4,452,292

Source: KKDLY LLC

Appendix C

IUCN Summary of Expenses by Natural Classification and Summary of Vendors Paid More Than $100,000 in Aggregate

Summary of Expenses by Natural Classification

Travel and lodging	$	1,556,253
Professional fees		1,279,922
Rentals conference equipment and communication systems		746,194
Salaries and related expenses		545,187
Legal fees		456,767
Security		134,754
Insurance		42,778
Office		32,302
Other		85,157
	$	4,879,314

Summary of Vendors Paid More Than $100,000 in Aggregate

Travelink, Inc.	$	788,441
International Convention Services		627,457
Conference Rental		620,160
International Union for Conservation		545,544
Carlsmith Ball LLP		515,086
Payroll - Randall Tanaka		336,056
Pacific Rim Concepts		140,035
Star Protection Agency LLC		134,754
Sheraton Princess Kaiulani Hotel		126,197
PSAV Presentation Services		126,034
Creative Fundraising Solutions		114,324
J Spargo and Associates, Inc.		108,288
	$	4,182,376

Source: KKDLY LLC

Office of the Auditor's Comments on the Department of Land and Natural Resources' Response to the Audit Findings

WE PROVIDED A DRAFT OF THIS REPORT to the Department of Land and Natural Resources (DLNR) and met with the Chairperson of the Board of Land and Natural Resources (Land Board), the Deputy to the Chairperson, the Land Division's Administrator, the Land Division's Assistant Administrator, the Land Division's Special Projects Coordinator, and the department's Fiscal Management Officer to discuss the draft report and its audit findings. On June 13, 2019, the department provided a written response to the draft report of our audit, which is included in its entirety as Attachment 1.

The draft report undergoes a very thorough internal review process to verify the adequacy of support in our workpapers for each statement in the report; however, in the event we missed evidence or misunderstood information that we gathered during the audit, the exit conference is the department's opportunity to correct those inaccuracies. It also allows us to explain information in the report that may be unclear to the department. At the outset, we are compelled to note that the Chairperson and the other department participants did not raise any substantive issue or concern about the draft report during our meeting. The primary purpose of the exit conference, which we explained to the Chairperson and others at the beginning of the audit and again at the exit conference, is to provide the department an opportunity to discuss our audit findings with us before the report is issued.

Instead of discussing the report during the exit conference, DLNR waited for its written response to raise questions about our audit findings. However, the department's position is primarily unsupported, composed of cursory statements, most of which are inconsistent, contradictory, or misleading; some are simply wrong. We note that the department employed a similar tactic when it to responded to our December 2018 report, which reviewed its special funds, revolving funds, trust funds, and trust accounts. This approach is neither a meaningful nor a productive means to address audit findings. As discussed more thoroughly herein, it ultimately reflects the department's poor understanding of certain aspects of the Land Division's operations and responsibilities.

We addressed the more significant statements made in DLNR's written response to the audit findings in the order raised by the department:

Strategic Planning

We reported that the Land Division does not have a strategic plan for the long-term management of its public lands or an asset management plan to identify and fulfill its obligations and goals related to the administration of those lands. We identified specific examples where, without such plans, the Land Division's management of its leases and revocable permits (RPs) must resort to simply maintaining the status quo, resulting in the loss of higher revenues and limiting the opportunities for others to lease those properties.

In its response, DLNR acknowledges that the Land Division does not have an "overarching plan" for the management of public lands, but represents that it will develop a strategic plan "covering lands under lease or revocable permit, as well as those unencumbered lands that may be suitable for development." However, we note that the department's response does not include a timeframe by which DLNR intends to develop the strategic plan. We emphasize the importance of a clear, comprehensive strategy for the long-term management of the Land Division's public lands for the Land Division, the department, and the Land Board to fulfill its responsibilities under the public trust doctrine and believe that the strategic plan should be a priority for the Land Division, the department, and the Land Board.

DLNR represents that it does have "detailed plans" for proposed developments on Maui and West O'ahu, that it calls "high priority" for income generation. We are puzzled by the department's inclusion of these projects in its response and their relevance to the coordinated management of the other properties, both developed and undeveloped, in the Land Division's land portfolio.

The department "strongly disagrees" with our statement that the Land Board members may be acting contrary to their responsibilities by favoring individual lessees above the rest of the public, asserting that the Land Board and the department do not place the interest of individual lessees above the rest of the public. That assertion, however, is directly contrary to the information we reported from a current board member:

When we asked a current Land Board member from Hawai'i Island about the extension of Kanoelehua Industrial Area (KIA) leases, he candidly admitted that many of the lessees were his friends, and he wanted to give them a chance to extend their leases, as he believed was appropriate under the law. The Land Board member is a former legislator who represented the Hilo district, and he told us that some of the KIA lessees are former political supporters and close friends.

The department incorrectly states that we are of the opinion that the Land Board and the department are under a fiduciary obligation to "maximize revenues" from its assets. In our report, we found that strategically growing income has not been a priority – or even a possibility – since the Land Division's lack of long-range planning has left its staff without the expertise, resources, or options to actively and effectively manage its land portfolio. In the case of the KIA leases, these deficiencies have left the Land Board with little choice but to extend leases, which has since become the norm. Retaining tenants – who pay below-market lease rents – without offering other members of the public the opportunity to bid for the leases is not in the public's interest and is not consistent with the Land Board's and DLNR's responsibilities.

The department also incorrectly contends that the enactment of laws allowing for the extension of leases demonstrates legislative intent that it is in the public interest to retain existing KIA tenants to the greatest extent feasible, rather than allowing leases to expire and seek higher rents. Act 207 (SLH 2011) provided that the Land Board, from time to time, ***may*** extend or modify the fixed rental period of the lease; it does not require the Land Board to retain the current tenants. Our finding is that the Land Division was ill-prepared to allow the leases to expire and convert the properties from ground leases to space leases. We also found that the Land Division's inability to conduct lease inspections may have contributed to the poor condition of some of the KIA properties. Frequent and diligent inspections would help ensure that lessees are in compliance with lease terms that require maintenance and upkeep of improvements "over and above normal wear and tear." Finally, we found that in some cases, the Land Division did not exercise due diligence in verifying substantial improvements promised by the lessees.

Special Land and Development Fund (SLDF)

The department objected to our reporting of its difficulties collecting delinquent rent. Specifically, KKDLY found that, of the $7.3 million in accounts receivable as of the end of June 2017, $2.1 million, or 29 percent, were more than 60 days old. Of the $2.1 million, the department determined that $1.6 million (75 percent) was uncollectible. The department did not dispute the accuracy of the information or otherwise explain its failure to collect the delinquent rent. Instead, DLNR tries to justify its poor collection record by arguing that other state departments, such as the Department of Agriculture, the Hawai‘i Public Housing Authority, Department of Transportation Harbors Division, among many others, as well as private-sector landlords have delinquency rates similar to the department's. By neglecting to mention the delinquency rates of other departments and agencies, the department alleges that criticism of DLNR's collection efforts is unwarranted.

The department's delinquency and uncollectible rates speak for themselves. DLNR simply needs to develop and adhere to formal written procedures for the collection of delinquent accounts receivable. DLNR's attempt to point fingers at other departments is directly contrary to the response we would expect an agency to have. The department must remember that the lands it manages are public lands and the delinquent rents are public funds. As a state agency, DLNR must be accountable for its decisions involving public moneys. The department also noted that the report failed to discuss the actual amount of annual revenues generated for the SLDF, pointing out that the fund's revenues grew from $6.3 million in 2010, to more than $20 million in 2018. According to the department, "The Department and Land Division should be congratulated instead of criticized."

Again, we beg to differ. The department's presentation of revenue numbers for the past nine years – absent any detail or context – is purposely misleading and not an indicator of the quality of the Land Division's management of the fund or its land portfolio. For example, the department chose to begin its showcase of its efforts in FY2010 ($6.3 million), neglecting to mention that it was a significant drop from FY2009's $9.1 million, FY2008's $8 million, and FY2007 $8.2 million. In addition, the department failed to mention or is not aware of the fact that $2.4 million of FY2017's $3.5 million increase was the result of the Legislature's appropriation of Transit Accommodations Tax moneys to the SLDF. Moreover, these funds should not have been categorized as revenue, since shortly thereafter, $2 million was transferred out of the SLDF and into the Park Development and Operations special fund and $400,000 to the Conservation and Resources Enforcement special fund. Moreover, the $4.4 million revenue bump from FY2017 to FY2018 was the result of the increase in the annual rent paid to the State by the Sand Island Business Association (SIBA) from $4.9 million to $9.3 million. As we reported, the rent increase represented the first time that SIBA tenants had paid near-market rates. The previous 25 years' rents had been discounted.

Imposing a premium on a lease extension would require a statutory or contractual basis

In regard to our observation that the Land Division did not consider adding a premium to KIA lease extensions, the department notes that it informally consulted with the Attorney General, which advised that a premium could not be enforceable under the statute. This information is new to us. During our audit, the Land Division said that it did not add a premium to the lease extensions because it believed the Land Board would not approve such an action. The division did not consult with the Attorney General regarding this decision. Unless it is content with maintaining the status quo and losing substantial revenue, we suggest

that the Land Division formally consult with the Attorney General about retaining such statutory authority.

The Land Board directed Land Division to review RP renewals more closely before Act 209 ordered the present audit.

In its response, the department wrote: "Statements that the audit report (page 22) incorrectly notes that RP rents have not been raised." Our report makes no such claim. Instead, it notes that RP rent adjustments have been "few and far between." This was confirmed by the Land Administrator who stated that "there have been rent adjustments, although not many." In addition, we also reported that the Land Division contracted appraisals for 113 of its approximately 340 RPs, which was completed in May 2018. The Land Board subsequently made adjustments to the RPs' rents. Whether these adjustments were "significant," as the department characterizes them, is a matter of debate. Rent increases were capped at 10 percent; however, as we reported, some RP rents were undervalued by as much as 1,000 percent.

Policies and Procedures

Policies and procedures are essential to ensure that the department's administration of leases and RPs is consistent and fair, not arbitrary and subjective; policies and procedures are important to ensure the department is operating efficiently and effectively and is accountable. As we reported, the land agents, who operate inconsistently with each other – are not performing certain department's responsibilities, such as annual inspections.

Instead, the department continues to assert its claim that its 308-page procedures manual provides proper guidance for its land agents and land management staff. As we reported, when we reviewed the manual, we found that it contained content on only 28 of the 78 processes listed. We asked the Land Division Administrator to identify where staff can find details and guidance on the 50 processes not supported in the manual, he referred us to a set of four binders, a 1,600-page collection of disparate documents. When we queried the Land Division's four land agents about their sources for policies and procedures, only one of them made even a passing reference to the document.

Transparency

The department is also puzzled by our questioning of the Land Division's belief that ceded land revenues (after OHA's 20 percent share) are intended to finance the division and other DLNR programs. The

department contends that its use of the moneys is consistent with the practices of every other department or agency that generates revenue from public trust lands. This may or may not be true. We did not audit those other departments and agencies. We did audit the SLDF, and we suggest that the department seek guidance from the Legislature concerning the interpretation of Section 5(f) of the Hawai‘i Admission Act.

Lastly, we reported that the SLDF is comprised of a parent account, S-316, and 24 sub-accounts. That information was provided to us ***by DLNR*** during our review of the department's special funds, revolving funds, trust funds, and trust accounts that was completed in December 2018. Yet, incredibly, in its response to this report, DLNR asserts that the SLDF consists of only the parent account, S-316, and one sub-account, S-318. More concerning, the Land Division, which administers the SLDF, incorrectly believes that "the funds were being deposited into the sister divisions' own special funds, if available, and if not, an administrative account outside of the SLDF." The department further states its understanding that "[t]he other accounts are the sub-accounts of the operating special fund of the division where the funds were transferred."

The department's and the Land Division's understanding of the SLDF – the special fund that is the funding source for the Land Division's operations and which it purportedly administers – is, frankly, very wrong. The SLDF comprises a total of 25 accounts: the parent account and 24 sub-accounts. Funds are transferred from the parent account into the various sub-accounts, which were created to fund specific programs and activities, most of which operate outside of the Land Division. The Land Division is responsible for administering the SLDF and must gain a better and more comprehensive understanding of the moneys in the SLDF and in its sub-accounts. The Land Division's misunderstanding of these multiple accounts, as reflected in DLNR's response to the audit findings, once again seems to highlight the department's poor management of these public moneys.

DAVID Y. IGE
GOVERNOR OF HAWAII

SUZANNE D. CASE
CHAIRPERSON
BOARD OF LAND AND NATURAL RESOURCES
COMMISSION ON WATER RESOURCE MANAGEMENT

ROBERT K. MASUDA
FIRST DEPUTY

M. KALEO MANUEL
DEPUTY DIRECTOR - WATER

AQUATIC RESOURCES
BOATING AND OCEAN RECREATION
BUREAU OF CONVEYANCES
COMMISSION ON WATER RESOURCE MANAGEMENT
CONSERVATION AND COASTAL LANDS
CONSERVATION AND RESOURCES ENFORCEMENT
ENGINEERING
FORESTRY AND WILDLIFE
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STATE OF HAWAII

Mr. Leslie H. Kondo, State Auditor
Office of the Auditor
465 S. King Street, Room 500
Honolulu, Hawai'i 96813-2917

Dear Mr. Kondo:

Thank you for the opportunity to respond to the draft performance audit report entitled *The Public Trust vs. Good Tenants: Audit of the Department of Land and Natural Resources' Special Land and Development Fund.*

As the draft report recognizes, the scope of the audit under Act 209, Session Laws of Hawaii 2017 (Act 209), was to conduct a performance audit of the Department of Land and Natural Resources' Special Land and Development Fund (SLDF) and Land Conservation Fund, including a review of contracts, grants, and memoranda of understanding entered into, awarded by, or otherwise involving those funds during the period July 1, 2015, through June 30, 2017, to determine whether funds were expended in compliance with laws and contractual agreements. However, the Auditor expanded the audit well beyond the mandate of Act 209 and embarked on a review of Land Division leasing and revocable permit practices. The draft audit report includes useful recommendations in some instances about these practices, but also reaches a number of subjective conclusions based on the Auditor's interpretation of the public trust. We discuss these further below.

We note that contrary to past practice, and despite our follow-up request, the Auditor's proposed recommendations were not included with the draft report, and we are therefore unable to comment on the recommendations.

Notwithstanding, through the Land Division's planning, implementing and accounting efforts, the annual revenues for the SLDF increased exponentially from $6.3 million in 2010, to over $20 million in 2018.

1. Strategic Planning.

    a. Land Division already engages in strategic planning for specific projects and annual review of all revocable permits, and is prepared to expand its planning efforts.

The draft report finds that the Department of Land and Natural Resources (Department)/Land Division does not have an overarching plan for the management of public lands. The Department clarifies that it has detailed plans for projects that are deemed high priority in terms of income generation, specifically the proposed industrial and business park at Pulehunui, Maui and a proposed mixed-use development in East Kapolei, Oahu adjacent to the University of Hawaii West Oahu planned rail station.[1] The Department also reviews the status of and plans for each revocable permit by county each year with the Land Board. Department acknowledges that it does not have an overall planning study encompassing all land under Land Division's management, but questions whether such a study could be conducted on a cost-effective basis. Nevertheless, the Department will develop a strategic plan covering lands under lease or revocable permit, as well as those unencumbered lands that may be suitable for development.

The Department strongly disagrees with the following opinion expressed by the Auditor on page 9 of the draft report:

> We believe that putting the interests of individual lessees above those of the rest of the public is an overly narrow interpretation of the public trust doctrine and raises questions about whether the Land Board members are fulfilling their fiduciary responsibilities.

First and foremost, the Board of Land and Natural Resources (Board) and the Department have not placed "the interests of individual lessees above those of the rest of the public". The draft report itself indicates that the Board's lease management decisions were made in consideration of multiple factors, such as balance, fairness, reasonableness, retention of good tenants and maintaining regional economic stability.

Furthermore, to the extent it is the Auditor's opinion that the Board and Department are under a fiduciary obligation to maximize revenue from its assets, the Department strongly disagrees with that position. This opinion is not supported by existing law or public policy. Pursuant to Article XI, Section 1 of the Hawaii State Constitution:

> For the benefit of present and future generations, the State and its political subdivisions shall conserve and protect Hawaii's natural beauty and all natural resources, including land, water, air, minerals and energy sources, and shall promote the development and utilization of these resources in a manner consistent with their conservation and in furtherance of the self-sufficiency of the State. All public natural resources are held in trust by the State for the benefit of the people.

[1] The Department's past attempts to increase the spending ceiling for the SLDF by $2.5 million for planning, environmental and entitlement purposes of various State properties was not approved by the legislature.

Rather, it is the obligation of the Board and the Department to seek a fair return for use of State lands to the extent prescribed in Chapter 171, Hawaii Revised Statutes. The Department believes strongly that is has complied with the appropriate statutory requirements in its management of leases.

b. Land Division implements legislative policy on extension of existing leases.

In regard to the Kanoelehua Industrial Area (KIA) leases, the draft report notes the following:

> The extensions granted to KIA lessees go against the public policy of opening state lands for competitive bidding or another public disposition process to provide opportunities for new lessees to lease state lands. By extending leases instead of allowing leases to expire, the State also lost the opportunity to receive market rents based on improved land.

On the contrary, the Legislature has determined that it is in the public interest to retain the existing KIA tenants to the greatest extent feasible, rather than allowing leases to expire and seeking higher rents. The Legislature has passed multiple measures to that effect with the strong support of KIA tenants, and that viewpoint was clearly expressed by both House and Senate members during committee hearings. Furthermore, if the Legislature concurs with the Auditor that certain lease extensions were granted that are inconsistent with the purpose, scope and requirements of the statute, then one option would be for the Legislature to consider amending the statute to further clarify or limit the extent to which lease extensions may be granted.

Additionally, the Auditor's analysis that the Department is forgoing revenue by not allowing the leases to expire, assuming ownership of the improvements and then executing space leases at a higher rent is superficial and flawed. The analysis fails to account for the costs to rehabilitate/reconstruct, manage and maintain the improvements against potential rent (which itself is not supported by an appraisal). Additionally, any evidence provided by the Auditor to address the cost issue is cursory and anecdotal. The Department notes that any improvements assumed at the end of a 65-year lease term would be well past any useful life, and it is unlikely that a tenant will invest in those improvements without an opportunity to extend the lease.

c. Sand Island Business Association

In regard to the Sand Island Business Association (SIBA) lease issues raised by the draft report, the Department believes that its decisions were reasonable. Given the significant revenues generated by this individual lease, the Department prioritized a solution that would help to ensure its continued viability in providing a stable revenue stream.

d. Imposing a premium on a lease extension would require a statutory or contractual basis.

The draft report suggests Land Division should have added a premium on leases extensions. But the Department's lease contracts do no allow for such a premium, and there is no statute that

authorizes the assessment of a premium to the lessee for an extension. As Land Division explained to the Auditor's staff over the course of the audit, the Department attempted in past years to impose conditions on lease extensions, including a requirement that the lessee pay for the appraisal required for reopening of rent in the extended lease term and that the lessee be precluded from protesting the rent so determined. The Board included those conditions in a number of lease extensions, but some lessees objected. When the Department sought legal advice on the propriety of the conditions, the Department of the Attorney General advised that those conditions were inconsistent with Chapter 171, HRS, and could not be enforced. An informal consultation with the Department of the Attorney General indicated that a lease extension premium imposed without a contractual or statutory basis would be similarly unenforceable.

e. The Land Board directed Land Division to review revocable permit renewals more closely before Act 209 ordered the present audit.

The draft report levels a number of criticisms against Land Division's management of its revocable permits. But the Board and the Revocable Permits Task Force convened by the Chairperson had begun scrutinizing the Department's revocable permits in 2016, and the Task Force presented its report to the Board at the meeting of June 24, 2016, Item D-7. The report sets forth a number of recommendations to improve the revocable permit system that have been largely implemented. Additionally, Land Division procured a portfolio appraisal report covering 113 revocable permits that was completed in May 2018. The Board made significant adjustments to revocable permit rents in 2018 and similar adjustments are anticipated for the renewals to be presented to the Board later this year. Statements on page 22 that RP rents have not been raised are incorrect. The draft audit itself notes the increases on pages 24 and 26.

2. Policies and Procedures.

The Land Division operates under statute and administrative rules, both of which have the effect of law. If the Board adopts a policy that is intended to expand or go beyond what is otherwise authorized by statute, it could be held to be improper rulemaking. To the extent the Auditor is suggesting that the Department pursue rulemaking, we disagree that Chapter 171, HRS, requires or needs rules — it is the most explicit statute on land dispositions and acquisitions in the State. In addition, we do not believe a Board with staggered membership or the Legislature would appreciate new rules that bind future Board action by preventing it from exercising its discretion or good judgment. Past polices that were in place but may not have been in the State's best interest include the pre-2012 policy of no sublease participation at all for the State unless the improvement unless were built or are owned by State.

Land Division has a 308-page procedures manual that covers a number of routine land dispositions. Land Division recognizes that it does not have written procedures for every task that its land agents and other staff must conduct on a day-to-day basis. Land Division will develop additional procedures for key tasks such as ensuring leasehold improvements are made in the manner approved by the Board.

3. Special Land and Development Fund (SLDF)

a. Revenues of the SLDF

First, the Auditor criticizes the Department's Land Division for having difficulties in collecting rents from delinquent or former tenants. However, the Auditor's report fails to cite to comparable delinquency rates from other State or County landlords (e.g., DOA, ADC, HPHA, HHFDC, DOT Harbors, DOT Airports, NELHA, HTDC, DOE, etc.) or the private sector. Therefore, the Department believes this criticism lacks support and is unwarranted. Second, what the Auditor's report fails to discuss is the actual amount of annual revenues generated for the SLDF. The Land Division has worked diligently to increase revenues for the SLDF to help support itself and the Department's conservation and resource protection programs. Through the Land Division's efforts, the annual revenues for the SLDF increased exponentially from $6.3 million in 2010, to over $20 million in 2018. See Cumulative Non-General Fund Report attached as Ex. 1. That's a +300% increase in less than 10 years. The Department and Land Division should be congratulated instead of criticized.

b. Transparency

The SLDF is governed by HRS 171-19 that specifically describes the type of revenues and receipts that can be deposited into the fund, and the allowable expenditures. HRS 171-19 is attached as Ex. 2. HRS 171-19 provides, inter alia, that all proceeds from the sale of public lands, including interest on deferred payments; all moneys collected under section 171-58 for mineral and water rights; all rents from leases, licenses, and permits derived from public lands; all moneys collected from lessees of public lands within industrial parks; all fees, fines, and other administrative charges collected under this chapter and chapter 183C, etc., may be deposited into the SLDF. Ex. 2.

The Department is puzzled by the Auditor questioning the Land Division's interpretation of HRS 171-19 and practice of, after setting aside 20% of ceded land revenues for OHA,[2] depositing the remaining 80% into the SLDF. This practice is consistent with applicable law and the express language in HRS 171-19, and is also consistent with the practices of every other department or agency that generates revenue from public trust lands, such as the DOE, DOT Airports, DOT Harbors, UH, HTDC, NELHA, DOA, ADC, HCDA, etc. See the Department's report that is filed annually with the legislature pursuant to Act 178, Session Laws of Hawaii 2006. It is unclear why the Auditor chose to single out the Land Division from all other State agencies that generate revenues from ceded lands.

Further, each year before the start of the legislative session, the Land Division submits the Non-General Fund Report for the SLDF. That report discloses the amount of transfers to other divisions and offices of the Department. See NGF reports for FY15-18 attached hereto as Ex. 3. Upon request, the Department regularly provided a detailed list of each division or program that received funds transferred from the SLDF. There was nothing wrong with these transfers as they all fit within the broad expenditure language of HRS 171-19 (Ex. 2) that provides that the SLDF funds may be used for, inter alia, the protection, planning, development, management,

[2] In accordance Act 178 and Exec. Order 06-06.

operations, maintenance and regulation of land and water under the direct control and management of the Board pursuant to Title 12, HRS. Title 12 includes the statutes for the different divisions, offices and programs within the Department. In consideration of the foregoing, the Department strongly believes that it has been transparent regarding the use of SLDF funds.

With respect to accounting of SLDF funds, Land Division administers the SLDF, specifically appropriation accounts S316 and S318 only, but effectively has no control of funds once transferred out of SLDF. Land Division understood the funds were being deposited into the sister divisions' own special fund, if available, and if not, an administrative account outside of the SLDF. Account S318 is the only sub-account of SLDF's parent account S316. The other accounts are the sub-accounts of the operating special fund of the division where the funds were transferred. These accounts were administratively established to receive transfer of funds from SLDF as mandated by the Legislature. Transferred SLDF funds are no longer accounted for by the Land Division because funds transferred belong to and are accounted for by the receiving division, intended to be used for its purpose, which is a legislatively approved expense appropriated and allotted in the receiving division. Additionally, appropriation S308 is the Department's special fund account administratively established to receive funding from the various divisions it supports. This account receives transfers of funds not only from SLDF but also from the different divisions for cost allocated charges.

Finally, with respect to the IUCN World Conservation Congress, the draft audit states that the East-West Center did not comply with procurement guidelines. This is incorrect. Procurement guidelines were followed carefully for dozens of transactions. The Department notes that it has previously reported to the Legislature in April 2017 that the IUCN World Conservation Congress came in significantly under budget due to the prudent fiscal management of Congress expenditures by the Host Committee and careful fiscal oversight by the Board of Directors of the Host Committee and DLNR, the event came in at 62% of budget.

The procurement process was finalized when the board was established. The significant purchase of services followed the rules established by the board, worksheets, budget allocation and sources were included for board approval. Documentation (originals) was provided to EWC fiscal department. KKDLY was unable to find documentation for a small minority of transactions. Please identify the missing documentation so that we have the opportunity to provide it.

Sincerely,

Suzanne Case

Suzanne D. Case
Chairperson

Enclosures

Reports on Non-General Fund Information

HISTORICAL DATA CHART

2006 to 2018 (and projections for 2019 to 2021)

Department: Land and Natural Resources
Prog ID(s): LNR 101
Name of Fund: Special Land and Development Fund
Legal Authority: Section 171-19, HRS

Contact Name: Russell Tsuji
Phone: 587-0422
Fund type (MOF): Special - B
Appropriation Acct. No.: S-316, S-318

Financial Data

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019 (estimated)	FY 2020 (estimated)	FY 2021 (estimated)
Appropriation Ceiling	$5,703,470	$6,353,470	$6,308,202	$6,496,430	$7,492,745	$6,633,699	$6,938,933	$7,903,267	$7,061,341	$8,469,163	$9,223,150	$11,149,738	$12,606,981	$12,718,613	$15,718,613	$15,718,613
Beginning Cash Balance	$5,535,377	$7,184,434	$8,986,966	$9,667,767	$9,248,449	$5,709,804	$6,542,484	$9,503,295	$10,506,869	$13,791,611	$12,221,047	$13,653,067	$16,647,735	$21,120,143	$22,985,714	$22,351,285
Revenues	$7,689,337	$8,245,477	$7,987,000	$9,086,344	$6,361,812	$8,716,473	$11,298,242	$13,123,746	$13,382,396	$12,313,732	$12,378,399	$15,847,414	$20,655,377	$20,220,000	$20,220,000	$20,220,000
Expenditures	$4,573,625	$5,078,912	$5,023,374	$6,123,957	$4,861,611	$4,928,423	$5,115,486	$5,903,806	$6,223,491	$6,586,987	$6,676,145	$9,245,606	$9,028,540	$9,500,000	$12,000,000	$12,000,000
Transfers - List each by JV# and date	($1,466,655)	($1,364,033)	($2,282,825)	($3,381,705)	($5,038,846)	($2,955,370)	($3,221,944)									
See Attached List								($6,216,367)	($3,874,163)	($7,297,309)	($4,270,234)	($3,697,140)	($7,154,429)	($8,854,429)	($8,854,429)	($8,854,429)
Net Total Transfers	($1,466,655)	($1,364,033)	($2,282,825)	($3,381,705)	($5,038,846)	($2,955,370)	($3,221,944)	($6,216,367)	($3,874,163)	($7,297,309)	($4,270,234)	($3,697,140)	($7,154,429)	($8,854,429)	($8,854,429)	($8,854,429)
Ending Cash Balance	$7,184,434	$8,986,966	$9,667,767	$9,248,449	$5,709,804	$6,542,484	$9,503,296	$10,506,869	$13,791,611	$12,221,047	$13,653,067	$16,647,735	$21,120,143	$22,985,714	$22,351,285	$21,716,856
Encumbrances	$2,033,963	$2,003,134	$1,611,582	$1,478,609	$1,069,254	$1,066,618	$974,058	$974,058	$987,067	$1,350,219	$3,180,527	$3,033,514	$2,965,074	$3,000,000	$6,000,000	$6,000,000
Unencumbered Cash Balance	$5,150,471	$6,983,832	$8,056,186	$7,769,840	$4,640,550	$5,475,866	$8,529,238	$9,532,811	$12,804,544	$10,870,828	$10,472,540	$13,614,221	$18,155,069	$19,985,714	$16,351,285	$15,716,856

EXHIBIT "I"

Form 37-47 (rev. 10/17/14)

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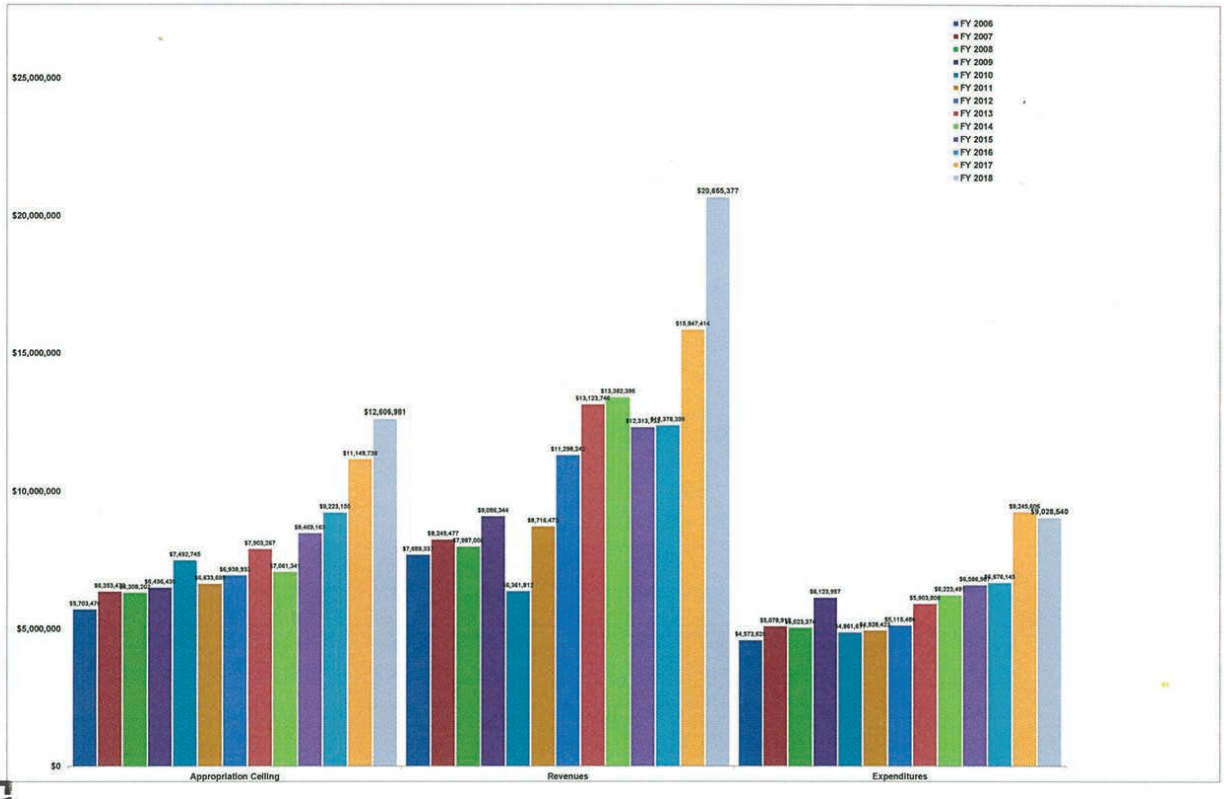
20181114 LNR 101 Histrorical Data Chart NGF 2006 to 2018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Appropriation Ceiling
Revenues
Expenditures

EXHIBIT "I"

§171-19 **Special land and development fund.** (a) There is created in the department a special fund to be designated as the "special land and development fund". **Subject to the Hawaiian Homes Commission Act of 1920, as amended, and section 5(f) of the Admission Act of 1959, all proceeds of sale of public lands, including interest on deferred payments; all moneys collected under section 171-58 for mineral and water rights; all rents from leases, licenses, and permits derived from public lands; all moneys collected from lessees of public lands within industrial parks; all fees, fines, and other administrative charges collected under this chapter and chapter 183C; a portion of the highway fuel tax collected under chapter 243; all moneys collected by the department for the commercial use of public trails and trail accesses under the jurisdiction of the department; transient accommodations tax revenues collected pursuant to section 237D-6.5(b)(5); and private contributions for the management, maintenance, and development of trails and accesses** shall be set apart in the fund and shall be used only as authorized by the legislature for the following purposes:

(1) To reimburse the general fund of the State for advances made that are required to be reimbursed from the proceeds derived from sales, leases, licenses, or permits of public lands;

(2) For the planning, development, management, operations, or maintenance of all lands and improvements under the control and management of the board pursuant to **title 12**, including but not limited to permanent or temporary staff positions who may be appointed without regard to chapter 76; provided that transient accommodations tax revenues allocated to the fund shall be expended as provided in section 237D-6.5(b)(5);

(3) To repurchase any land, including improvements, in the exercise by the board of any right of repurchase specifically reserved in any patent, deed, lease, or other documents or as provided by law;

(4) For the payment of all appraisal fees; provided that all fees reimbursed to the board shall be deposited in the fund;

(5) For the payment of publication notices as required under this chapter; provided that all or a portion of the expenditures may be charged to the purchaser or lessee of public lands or any interest therein under rules adopted by the board;

(6) For the management, maintenance, and development of trails and trail accesses under the jurisdiction of the department;

EXHIBIT "2"

(7) For the payment to private land developers who have contracted with the board for development of public lands under section 171-60;

(8) For the payment of debt service on revenue bonds issued by the department, and the establishment of debt service and other reserves deemed necessary by the board;

(9) To reimburse the general fund for debt service on general obligation bonds issued to finance departmental projects, where the bonds are designated to be reimbursed from the special land and development fund;

(10) For the protection, planning, management, and regulation of water resources under chapter 174C; and

(11) For other purposes of this chapter.

(b) Notwithstanding the above provisions, but subject to the restrictions contained in section 5(f) of the Admission Act, whenever the board sells remnants to abutting owners, the proceeds therefrom including interest on deferred payments, shall be deposited into the general fund; provided that such proceeds shall be set apart to the appropriate fund where mandatory federal requirements affecting federal funds so require.

(c) Notwithstanding the above limitations on use of the proceeds of sale, where the board sells public lands including the buildings thereon once used but no longer necessary for school purposes at the recommendation and request of the board of education, all net proceeds derived from the sales shall be used for the acquisition of land or for the erection of buildings for school purposes to the extent of an approved building plan in the departmental school district wherein the sales occur. In the absence of any school building program in the district or in the event of any surplus remaining after the completion of buildings constructed pursuant to the approved plan then the proceeds or surplus shall be used in other departmental school districts in the county wherein the sales occur.

(d) When use of the fund is authorized by the legislature for the development of public lands for a particular project, to be disposed of by sale, lease, license, or permit, the board may pay from the fund the costs of the development, including the costs of surveys, construction of roads, water lines, sewer lines, and such other improvements as may be necessary for the development of the lands; provided that the project shall meet

EXHIBIT "2"

with the zoning and subdivision requirements of the appropriate county government in which the lands are located, except that plans and specifications for recreational projects, including access roads therefor, shall not be required to meet with such approval; and provided further that no such development of public lands for disposal by sale, lease, license, or permit shall be made unless appropriate roads, water lines, and other improvements are installed which will make the land usable for the purpose for which it is being disposed at the time of disposition.

(e) All unexpended and unencumbered moneys remaining on balance with the fund at the close of each fiscal year which are deemed, by the director of finance, to be in excess of the moneys necessary to carry out the purposes of this section over the next following fiscal year shall lapse to the credit of the state general fund. [L 1962, c 32, pt of §2; am L 1963, c 29, §1; am L 1964, c 35, §2 and c 49, §1; am L 1965, c 239, §40; Supp, §103A-19; am L 1967, c 234, §5; HRS §171-19; am L 1970, c 83, §1; am L 1976, c 50, §1; am L 1981, c 82, §17; am L 1985, c 40, §1; am L 1988, c 361, §3; am L 1989, c 25, §1; am L 1993, c 280, §53; am L 1997, c 106, §1; am L 1999, c 160, §16; am L 2000, c 122, §1, c 203, §1, and c 253, §150; am L 2003, c 113, §1; am L 2010, c 209, §§2, 5; am L 2015, c 117, §2 and c 121, §5]

Note

The amendment to subsection (a) by L 2015, c 117, §2, effective July 1, 2016, was also made by L 2015, c 121, §5, effective June 12, 2015. L 2015, c 117, §§2, 11 and c 121, §§5, 17.

Performance audit of the fund; report to 2019 legislature. L 2017, c 209.

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EXHIBIT "2"

Report on Non-General Fund Information
for Submittal to the 2015 Legislature

Department:	Land and Natural Resources	Contact Name:	Russel Tsuji
Prog ID(s):	LNR 101	Phone:	587-0422
Name of Fund:	Special Land and Development Fund	Fund type (MOF)	Special - B
Legal Authority	Section 171-19, HRA	Appropriation Acct. No.	S-316. S-318

Intended Purpose:
The purpose of the fund is to finance the development of a comprehensive public land trust information system to inventory and maintain information about the lands of the public land trust described in section 5(f) of the Admission Act and article XII, section 4 of the Hawaii State Constitution.
Source of Revenues:
Act 54, SLH 2011 apropriated funds $360,000 ($275,000 in FY12 and $85,000 in FY13), from the Land Conservation Fund.
Current Program Activities/Allowable Expenses:
Staff salaries and contact cost for development of information system
Purpose of Proposed Ceiling Increase (if applicable):

Variances:
Revenues are anticipated to bump up in excess of 10% in 2018 due to a known rental increase for a particular lease reopening.

Financial Data	FY 2012 (actual)	FY 2013 (actual)	FY 2014 (actual)	FY 2015 (estimated)	FY 2016 (estimated)	FY 2017 (estimated)	FY 2018 (estimated)
Appropriation Ceiling	6,938,933	7,903,267	7,061,341	8,429,813	7,507,597	7,591,302	7,591,302
Beginning Cash Balance	6,542,484	9,503,296	10,506,869	14,027,383	15,527,383	17,627,383	19,727,383
Revenues	11,298,242	13,123,746	13,382,396	13,300,000	13,300,000	13,300,000	15,800,000
Expenditures	5,115,486	5,903,806	6,223,491	6,200,000	6,200,000	6,200,000	6,200,000
Transfers							
List each by JV# and date	(3,221,944)	(6,216,367)					
See Attached List			(3,638,391)	(5,600,000)	(5,000,000)	(5,000,000)	(5,000,000)
Net Total Transfers	(3,221,944)	(6,216,367)	(3,638,391)	(5,600,000)	(5,000,000)	(5,000,000)	(5,000,000)
Ending Cash Balance	9,503,296	10,506,869	14,027,383	15,527,383	17,627,383	19,727,383	24,327,383
Encumbrances	974,058	987,067	1,729,833	2,000,000	1,300,000	1,300,000	1,300,000
Unencumbered Cash Balance	8,529,238	9,519,802	12,297,551	13,527,383	16,327,383	18,427,383	23,027,383

Additional Information:

Amount Req. by Bond Covenants							
Amount from Bond Proceeds							
Amount Held in CODs, Escrow Accounts, or Other Investments							

EXHIBIT "3"

Report on Non-General Fund Information
for Submittal to the 2016 Legislature

Department:	Land and Natural Resources	Contact Name:	Russell Tsuji
Prog ID(s):	LNR 101	Phone:	587-0422
Name of Fund:	Special Land and Development Fund	Fund type (MOF)	Special - B
Legal Authority	Section 171-19, HRA	Appropriation Acct. No.	S-316. S-318

Intended Purpose:
To fund the operations of the Land Management Division and to assist with funding for the operations and maintenance of public lands under the management jurisdiction of the Board and Department of Land and Natural Resources.

Source of Revenues:
Primary sources of funding for the Special Land and Development Fund include rents from leases and land dispositions of the Land Management Division.

Current Program Activities/Allowable Expenses:
Key activities include sales in fee, sale of general leases, issuance of revocable permits and the maintenance of public lands.

Purpose of Proposed Ceiling Increase (if applicable):
FY16 proposed ceiling increase is for the reauthorized spending ceiling for redesign/upgrade of State Lands Information Management System (SLIMS) and to account for the revised fringe benefit rate.

Variances:
Revenues are anticipated to increase in excess of 10% in 2018 due to a known rental increase for a particular lease reopening.

Financial Data

	FY 2013 (actual)	FY 2014 (actual)	FY 2015 (actual)	FY 2016 (estimated)	FY 2017 (estimated)	FY 2018 (estimated)	FY 2019 (estimated)
Appropriation Ceiling	7,903,267	7,061,341	8,469,163	9,147,038	9,223,150	9,223,150	9,223,150
Beginning Cash Balance	9,503,296	10,506,869	13,791,611	12,221,047	12,521,047	12,621,047	16,421,047
Revenues	13,123,746	13,382,396	12,313,732	13,300,000	13,300,000	15,800,000	15,800,000
Expenditures	5,903,806	6,223,491	6,586,987	7,000,000	7,200,000	7,500,000	7,800,000
Transfers							
List each by JV# and date	(6,216,367)	(3,874,163)					
See Attached List			(7,297,309)				
Net Total Transfers	(6,216,367)	(3,874,163)	(7,297,309)	(6,000,000)	(6,000,000)	(4,500,000)	(4,500,000)
Ending Cash Balance	10,506,869	13,791,611	12,221,047	12,521,047	12,621,047	16,421,047	19,921,047
Encumbrances	974,058	987,067	1,350,219	2,300,000	1,500,000	1,500,000	1,500,000
Unencumbered Cash Balance	9,532,811	12,804,544	10,870,828	10,221,047	11,121,047	14,921,047	18,421,047

Additional Information:

Amount Req. by Bond Covenants							
Amount from Bond Proceeds							
Amount Held in CODs, Escrow Accounts, or Other Investments							

EXHIBIT "3"

Form 37-47 (rev. 10/17/14)

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LNR 101 Land NGF (fin)

Report on Non-General Fund Information
for Submittal to the 2018 Legislature

Department:	Land and Natural Resources	Contact Name:	Russell Y. Tsuji
Prog ID(s):	LNR 101	Phone:	587-0422
Name of Fund:	Special Land and Development Fund	Fund type (MOF)	Special - B
Legal Authority	Section 171-19, HRA	Appropriation Acct. No.	S-316, S-318

Intended Purpose:
To fund the operations of the Land Management Division and to assist with funding for the operations and maintenance of public lands under the management jurisdiction of the Board and Department of Land and Natural Resources.

Source of Revenues:
Primary sources of funding for the Special Land and Development Fund include rents from leases and land dispositions of the Land Management Division.

Current Program Activities/Allowable Expenses:
Key activities include sales in fee, sale of general leases, issuance of revocable permits and the maintenance of public lands.

Purpose of Proposed Ceiling Adjustment (if applicable):

Variances:

Financial Data							
	FY 2014 (actual)	FY 2015 (actual)	FY 2016 (actual)	FY 2017 (actual)	FY 2018 (estimated)	FY 2019 (estimated)	FY 2020 (estimated)
Appropriation Ceiling	7,061,341	8,469,163	9,223,150	11,149,738	12,606,981	13,700,000	13,700,000
Beginning Cash Balance	10,506,869	13,791,611	12,221,047	13,653,067	16,647,735	20,695,149	20,942,563
Revenues	13,382,396	12,313,732	12,378,399	15,847,414	18,347,414	18,347,414	18,347,414
Expenditures	6,223,491	6,586,987	6,676,145	9,245,606	9,800,000	10,800,000	10,800,000
Transfers							
List each net transfer in/out/ or projection in/out; list each account number							
	(3,874,163)	(7,297,309)	(4,270,234)	(3,607,140)	(4,500,000)	(7,300,000)	(7,300,000)
Net Total Transfers	(3,874,163)	(7,297,309)	(4,270,234)	(3,607,140)	(4,500,000)	(7,300,000)	(7,300,000)
Ending Cash Balance	13,791,611	12,221,047	13,653,067	16,647,735	20,695,149	20,942,563	21,189,977
Encumbrances	987,067	1,350,219	3,180,527	3,033,514	3,300,000	4,000,000	4,500,000
Unencumbered Cash Balance	12,804,544	10,870,828	10,472,540	13,614,221	17,395,149	16,942,563	16,689,977

Additional Information:

Amount Req. by Bond Covenants							
Amount from Bond Proceeds							
Amount Held in CODs, Escrow Accounts, or Other Investments							

EXHIBIT "3"

Report on Non-General Fund Information
for Submittal to the 2018 Legislature

Department: Land and Natural Resources
Prog ID(s): LNR 101
Name of Fund: Special Land and Development Fund
Legal Authority Section 171-19, HRA

Contact Name: Russell Y. Tsuji
Phone: 587-0422
Fund type (MOF) Special - B
Appropriation Acct. No. S-316, S-318

Intended Purpose:
To fund the operations of the Land Management Division and to assist with funding for the operations and maintenance of public lands under the management jurisdiction of the Board and Department of Land and Natural Resources.

Source of Revenues:
Primary sources of funding for the Special Land and Development Fund include rents from leases and land dispositions of the Land Management Division.

Current Program Activities/Allowable Expenses:
Key activities include sales in fee, sale of general leases, issuance of revocable permits and the maintenance of public lands.

Purpose of Proposed Ceiling Adjustment (if applicable):

Variances: 2018 revenue increase due to Sand Island Industrial Park.
Transient accomodation tax, $3,000,000. TAT limited to State Parks; DOCARE and OCCL. Increased Expenditure and encumbraces projections Pulehunui and East Kapolei development projects and Hilo Land Offices GM needed for ceiling increases

Amount transferred increased due to collective bargaining increases and $500K appropriation from Act 181 (SLH 2

Financial Data

	FY 2015 (actual)	FY 2016 (actual)	FY 2017 (actual)	FY 2018 (actual)	FY 2019 (estimated)	FY 2020 (estimated)	FY 2021 (estimated)
Appropriation Ceiling	8,469,163	9,223,150	11,149,738	12,606,981	12,718,613	15,718,613	15,718,613
Beginning Cash Balance	13,791,611	12,221,047	13,653,067	16,647,735	21,120,143	22,985,714	22,351,285
Revenues	12,313,732	12,378,399	15,847,414	20,655,377	20,220,000	20,220,000	20,220,000
Expenditures	6,586,987	6,676,145	9,245,606	9,028,540	9,500,000	12,000,000	12,000,000
Transfers							
List each net transfer in/out/ or projection in/out; list each account number							
See attached list	(7,297,309)	(4,270,234)	(3,607,140)	(7,154,429)	(8,854,429)	(8,854,429)	(8,854,429)
Net Total Transfers	(7,297,309)	(4,270,234)	(3,607,140)	(7,154,429)	(8,854,429)	(8,854,429)	(8,854,429)
Ending Cash Balance	12,221,047	13,653,067	16,647,735	21,120,143	22,985,714	22,351,285	21,716,856
Encumbrances	1,350,219	3,180,527	3,033,514	2,965,074	3,000,000	6,000,000	6,000,000
Unencumbered Cash Balance	10,870,828	10,472,540	13,614,221	18,155,069	19,985,714	16,351,285	15,716,856

Additional Information:

Amount Req. by Bond Covenants							
Amount from Bond Proceeds							
Amount Held in CODs, Escrow Accounts, or Other Investments							

EXHIBIT "3"