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January 15, 2015

Senator Richard Cohen, Chair  
Senate Finance Committee  
301 State Capitol 443  
St. Paul, MN 55155

Representative Jim Knoblach, Chair  
House Ways and Means Committee  
453 State Office Building  
St. Paul MN, 55155

Senator Bobby Joe Champion, Vice Chair  
Senate Finance Committee  
306 State Capitol  
St. Paul, MN 55155

Representative Tony Albright, Vice Chair  
House Ways and Means Committee  
407 State Office Building  
St. Paul, MN 55155

Senator Michelle Fischbach  
Ranking Minority Member  
Senate Finance Committee  
15 State Office Building  
St. Paul, MN 55155

Representative Lyndon Carlson  
Ranking Minority Member  
House Ways and Means Committee  
283 State Office Building  
St. Paul, MN 55155

RE: Agency Acquisition of Real Property Report

Dear Senators and Representatives:

Laws of Minnesota 2014, Ch. 304, section 2 directs Minnesota Management & Budget to prepare and submit the attached report to the chairs and ranking members of each of the legislative committees with jurisdiction over policy and finance relating to real property acquisition by the state.

Questions regarding this report may be directed to John Pollard at (651) 201.8039.

Sincerely,

A handwritten signature in blue ink, appearing to read "Roger Fournier", is written over a faint, light blue grid background.

Commissioner

cc: Senator Terri Bonoff  
Eric Nauman, Senate Fiscal Analyst  
Bill Marx, House Fiscal Analyst

# Agency Acquisition of Real Property

Submitted to the Minnesota Legislature by  
Minnesota Management & Budget

Minnesota Management & Budget | January 2015

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## EXECUTIVE SUMMARY

State agencies, non-profit organizations, the Minnesota State Colleges and Universities, the University of Minnesota and political subdivisions of the state all expend public dollars to purchase real property in order to fulfill a public purpose. Because of the unique nature of their respective underlying purposes, a complex body of law has evolved to address the procurement of real property for the public good.

Through specific legislation, several mechanisms have developed that provide accountability and fiduciary oversight of real property expenditures, including agency-specific processes and price caps, case-by-case review of purchases, and real property expenditure category exceptions.

Minnesota Statutes 2014 § 16B.297 (MS 16B.297) establishes procedures for affected agencies in acquiring real property, including appraisals and a maximum price cap of 110 percent of the appraised value of the property. It also provides affected agencies with pricing discretion when real property is appraised at less than \$100,000.

A review of a pending MnSCU real property purchase by the chairs of the House Ways and Means Committee and the Senate Finance Committee under MS 136F.60 prompted the enactment of MS 16B.297. MnSCU proposed purchasing a residential property for a parking lot for a price that significantly exceeded the property's assessed value. The legislature directed Minnesota Management & Budget (MMB) to prepare a report regarding "what information and documentation related to the parties' administrative costs should be required before the state agrees to acquire real property or an interest in real property. The commissioner, as part of the report, shall recommend whether exceptions to the requirements of MS 16B.297, are necessary to protect the public interest, and make recommendations for appropriate exceptions, if any."

This report addresses the legislature's request for input on the necessity and criteria for exceptions to MS 16B.297, either in its entirety or on a case-by-case basis. It also provides recommendations about administrative costs and which situations necessitate various types of information and documentation, a subject of ongoing debate between the legislature, state agencies and recipients of public funding.

In preparing this report, MMB interviewed legislative staff, legislation authors and selected agency personnel; reviewed legislative hearing video and audio recordings; reviewed an evaluation report of the Office of the Legislative Auditor (The Legacy Amendment) and consulted past MMB guidance that it has provided to agencies on general administrative costs.

The report recommends that there are cases where an exception to the maximum price feature of the new statute should be considered in order to better balance legislative fiscal and policy objectives. Specifically, MMB recommends that:

- The scope of MS 16B.297 remains narrow in its application to MnSCU and state agencies defined in MS 16B.01, subdivision 2 (here forward referred to as "affected agencies").
- The maximum price of 110 percent of appraised value applies only to cost of the property and does not include administrative costs.
- Affected agencies may seek exception to the 110 percent price cap to be reviewed by a legislatively identified forum.

The report also recommends that the amount and degree of documentation required for administrative costs prior to the State acquiring interests in real property should depend on the type of cost, the relative expense of the land purchase and the necessity of the purchase to fulfill the agency's purpose. Costs that are relatively low, ubiquitous and present less financial risk—such as copying—should be of less concern than more expensive, situation-specific costs—such as hiring professional support or acquiring land indirectly—should require additional documentation and review more often.

## INTRODUCTION

Laws of Minnesota 2014, Ch. 304, codified as MS 16B.297, was enacted in response to a pending real property purchase submitted to the House Ways and Means and Senate Finance Committees by the Minnesota State Colleges and Universities (MnSCU) under MS 136F.60.

Of primary concern was MnSCU's proposed purchase price that exceeded the appraised value of the property by more than 100 percent. In reaction, subdivision 2 of MS 16B.297 places a cap on the maximum price that certain state agencies may pay no more than 110 percent of its appraised value for an interest in real property.<sup>1</sup> Notably, this legislation expressly excludes the Minnesota Departments of Transportation (MnDOT), Natural Resources (DNR) and the Board of Soil and Water Resources (BWSR). These three entities are the largest state agency purchasers of real property and were not included because, according to interviewees, they were deemed effectively regulated.

Also subject to this statute are purchases of interests in real property made by all other agencies. As a practical matter, appropriations for such purchases are made to Real Estate and Construction Services (RECS) division of the Minnesota Department of Administration. RECS, pursuant to MS 16B.31, subd. 5, then proceeds to acquire the real property interest on an agency's behalf.

According to those interviewed, the language introduced in the original House and Senate bills leading to this was based on legislation previously enacted for the DNR.<sup>2</sup>

Section 2 of the Laws of Minnesota 2014, Ch. 304, directs Minnesota Management & Budget (MMB) to report to the chairs and ranking minority members of the legislative committees with jurisdiction over policy and finance relating to real property acquisition by the State on:

- Exceptions to the requirements of MS 16B.297 that would be necessary to protect the public interest
- Information and documentation related to administrative costs that should be required before the state agrees to acquire real property or an interest in real property

MMB interprets that the required report be submitted to the chairs and ranking minority members of the House Ways and Means and Senate Finance committees.

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<sup>1</sup> Throughout this report the phrase "interest in real property" means "real property or interest in real property."

<sup>2</sup> MS 84.0272. This statute states in part, "The commissioner of natural resources may pay less than the appraised value, but shall not agree to pay more than ten percent above the appraised value, ... if the commissioner determines that lands or interests in land have a value less than \$100,000, the commissioner may acquire the lands for the value determined by the commissioner without an appraisal."

## METHODOLOGY

In preparing this report MMB conducted interviews with the following individuals:

### Senate

- Senator Terri Bonoff, Senate Finance Committee
- Dave Kornecki, Senate Finance Committee administrator
- Greg Knopff, Senate lead analyst
- John Fuller, Senate Counsel

### House

- Representative Lyndon Carlson, House Ways and Means Committee
- Representative Steve Drazkowski
- Representative Steve Green
- Nancy Conley, Ways and Means Committee administrator
- Legislative Analyst Deborah Dyson, House Research Department
- Chief Fiscal Analyst Bill Marx, House Fiscal Analysis Department
- Fiscal Analyst Andrew Lee, House Fiscal Analysis Department

### Agencies, MnSCU and University of Minnesota

- Curt Yoakum and Wayne Waslaski, Department of Administration
- John Pollard, MMB
- John Jaschke and Sarah Strommen, BWSR
- Susan Damon and Kathy Lewis, Department of Natural Resources
- Bryan Dodds, Rick Morey, Joe Pignato and Donald Goedken, Department of Transportation
- Greg Ewig, MnSCU
- Susan Weinberg, University of Minnesota

In addition to reviewing initial bills, engrossments, legislative hearing video and audio recordings, MMB also reviewed the Legislative Auditor's evaluation report *The Legacy Amendment and MMB Guidance to Agencies on Legacy Fund Expenditure*. Also a cursory inquiry into public property acquisition practices of nearby state jurisdictions was made. This research does not indicate that Minnesota's agency practices differ appreciably from those employed by other selected states (Wisconsin, Iowa, and Michigan).

Finally, interviewees had different interpretations regarding the scope and purpose of the legislatively directed report. MMB has sought, to the best of its ability, to be guided by MS 645.16,<sup>3</sup> as well as the comments of the interviewees.

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<sup>3</sup> MS 645.16, reads, in whole:

#### **LEGISLATIVE INTENT CONTROLS.**

The object of all interpretation and construction of laws is to ascertain and effectuate the intention of the legislature. Every law shall be construed, if possible, to give effect to all its provisions.

When the words of a law in their application to an existing situation are clear and free from all ambiguity, the letter of the law shall not be disregarded under the pretext of pursuing the spirit.

When the words of a law are not explicit, the intention of the legislature may be ascertained by considering, among other matters:

- 1) the occasion and necessity for the law;
- 2) the circumstances under which it was enacted;
- 3) the mischief to be remedied;
- 4) the object to be attained;
- 5) the former law, if any, including other laws upon the same or similar subjects;

## BACKGROUND

The Minnesota legislature has enacted numerous statutes to facilitate the purchase of interests in real property to carry out diverse public policy objectives, ranging from environmental and natural resource protection to education, transportation and public enjoyment. Different intended uses of purchased interests in real property have correspondingly different near, mid- and long-term financial implications regarding subsequent legislative authorizations for expenditures. For example, a purchase of real property for the construction of state education purposes often results in the subsequent use of bonding authority to complete construction of facilities on the property. In other cases, a real property purchase might require that the land either be restored to its natural state or remain “undeveloped,” in which case remediation dollars or an ongoing appropriation is needed to carry out the program purpose of the property.

In addition, there is a trend in which certain agency-initiated purchases by the DNR have been shifted by the legislature to non-profit organizations acting on behalf of the State of Minnesota. According to some, this has increased the complexity of monitoring the purchase price of such property interests, because they are one step removed from the agency. Moreover, if such a property interest is ultimately transferred to the state, future costs are often incurred to manage the acquisition.

Finally, some interviewees felt that the cumulative effect of purchases using public funds may be having a negative effect on the valuation of nearby real property owned by tax-paying Minnesota citizens. It was stated that a nearby tax-paying citizen was contributing to a purchase that as, a private land owner, was also increasing his or her property taxes due to an increase in their property value (when the public sector paid more than the county-assessed value) and a corresponding decrease in the overall county property tax base.

While the instant statute is quite narrow in its application, it is against this backdrop that the MnSCU purchase was assessed and the resulting legislation enacted.

## MNSCU PROPOSED PURCHASE

In January, 2013, the MnSCU Board of Trustees authorized the issuance of revenue bonds for various projects, including the construction of a parking ramp and student center at Metropolitan State University's main campus. The ramp, in part, was to provide sufficient parking capacity for a proposed Science Education Center contained in MnSCU's 2014 capital budget request to the legislature.

Because Metropolitan State University is “land-locked,” it was necessary to acquire three adjacent residential properties for the construction of the planned ramp. MnSCU was able to secure two of the properties, but not the third—an unoccupied single family house—which needed to be removed for a planned surface lot. The appraised value of the property was \$125,000. MnSCU offered \$275,000 if the tenant removed the building from the property, or \$225,000 if MnSCU was to remove it.

## PRIOR NOTIFICATION

An important feature of Minnesota law is the opportunity for legislative oversight of pending MnSCU real property purchases. Under MS 136F.60, MnSCU is directed to notify the House Ways and Means and Senate Finance Committees of certain pending purchases of real property. Specifically, MS 136F.60, subd. 1 states:

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- 6) the consequences of a particular interpretation;
  - 7) the contemporaneous legislative history; and
  - 8) legislative and administrative interpretations of the statute.



The board may purchase property adjacent to or in the vicinity of the campuses as necessary for the development of a state college or university. Before taking action, the board shall consult with the chairs of the senate Finance Committee and the house of representatives Ways and Means Committee about the proposed action. The board shall explain the need to acquire property, specify the property to be acquired, and indicate the source and amount of money needed for the acquisition. The funds needed may be spent from sums previously appropriated for purposes of the state colleges and universities, including, but not limited to, general fund appropriations for instructional or noninstructional expenditures, general fund appropriations carried forward, or state college and university activity fund appropriations. The board may pay relocation costs, at its discretion, when acquiring property.

The prior notification requirement for pending MnSCU purchases also applies to pending purchases by Real Estate Management under MS 16B.335. In both cases, the legislative review is “advisory.” Nevertheless, interviewees noted as a practical matter that an adverse opinion by either chair is likely to have a significant impact on whether a proposed purchase is executed. Typically, the acquisition of a property is a preliminary step to construction requiring bonding authority or future appropriations for the proposed purchase.

MnSCU made the required notification. The chair of the House Ways and Means Committee thought the proposed offer, nearly 100 percent greater than the appraised value, was too high, and expressed his concerns, introducing legislation that resulted in a maximum price cap for no more than 110 percent of the appraised value of the property. Given an appraised value of \$125,000, under this statute MnSCU would be authorized to offer no more than \$137,500.

On March 19, 2014, the Board of Trustees of MnSCU authorized the chancellor to take all necessary steps to complete the acquisition of the third property by direct negotiation, settlement or eminent domain process. As a practical matter, although eminent domain proceedings could be pursued<sup>4</sup>—even via an accelerated process known as “quick track”—it is a lengthy process with the benefits of a lower purchase price offset by delayed construction schedules and increased costs.

As of the date of this report, the needed property has not been acquired, and MnSCU was exploring numerous options, including eminent domain.

## EXCEPTIONS TO MS 16B.297

The final statute emerging out of conference committee on the last day of the 2014 session is MS 16B.297. It is narrow in scope, applying to selected state agencies and MnSCU. Specifically, it requires an appraisal be conducted by certified appraisers, establishes procedures, places a maximum price of 110 percent of appraised value paid by the State of Minnesota for acquiring real property or an interest in real property and provides an exemption for purchase of less than \$100,000.<sup>5</sup>

In considering exceptions to MS 16B.297, MMB focused on its scope, maximum price provision, appraisal requirement and agency discretion for purchases of less than \$100,000.

## SCOPE

MS 16B.297 applies to the executive branch of the state of Minnesota under MS 16B.01, subd. 2 and MnSCU (hereinafter “affected agencies”). It specifically exempts the DNR, BWSR and MnDOT from its land

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<sup>4</sup> MnSCU is authorized to pursue condemnation proceeding under MS 117 to acquire real property for “enjoyment of the land by the general public or by public agencies.”

<sup>5</sup> See Appendix 1 for the full text.

acquisition requirements. Legislative testimony, interviews and a review of relevant Minnesota law confirm that these agencies operate under property acquisition statutes tailored to their respective legislative missions. Citations to these statutes may be found in the footnotes below for the DNR,<sup>6</sup> BWSR<sup>7</sup> and MnDOT.<sup>8</sup>

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## FINDINGS

While the final scope and application of MS 16B.297 is not disputed, some interviewees expressed that as a matter of public policy the concept of a price cap be more broadly applied to all purchases of interests in real property when funded with “public money.”

If the scope was broadly extended to any expenditure of “public money,” it would not only apply to purchases by all state agencies, but also to all political subdivisions of the state,<sup>9</sup> non-profit grant recipients of public

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<sup>6</sup> The DNR is subject to MS 84.0272. MS 84.0272 generally requires the commissioner of natural resources to cause lands to be appraised before acquisition and limits the circumstances under which more than appraised value may be paid. There are four exceptions for the appraisal requirement. First, with the prior consent of the landowner, the commissioner may value a stream easement through a formula set forth in MS 84.0272, subd. 2. Second, if the commissioner determines that land or an interest in land has a value less than \$100,000, the commissioner may, with the prior consent of the landowner, use a minimal valuation process prescribed in MS 94.0272, subd. 3. Third, the commissioner has the discretion to value Camp Ripley’s Army compatible use buffer easements through a formula set forth in MS 84.0277. Finally, MS 84.96 requires payment to a landowner for a native prairie bank easement to be determined by formula. See Appendix 2 for a list of Federal and state laws governing DNR land acquisitions.

The DNR is also subject to land acquisition requirements in Outdoor Heritage Fund and Environment and Natural Resources Trust fund appropriation laws. *See, e.g.*, Minn. Laws 2014 226, 256. In addition, the DNR is subject to state and federal environmental laws.

<sup>7</sup> MS 103F.515 provides the authority and the criteria for BWSR to establish RIM (Re-Invest in Minnesota) conservation easement payment rates which are set to achieve 90% of Fair Market Value (FMV) for cropland and 60% of Fair Market Value (FMV) for non-cropland. The FMV amounts are determined for each township by the University of Minnesota using reported sales from each County Assessor to the Department of Revenue and posted on the Land Economics website at <http://www.landeconomics.umn.edu/MLE/landdata/LandValue/RunReport.aspx?RI=247406>.

<sup>8</sup> MnDOT is exempt from MS 16B.297. MnDOT follows state and federal statutes as well as internal policies as it relates to appraisals, negotiations, condemnation, disposal and eligible costs for direct and indirect purchases of real property or interests in real property. In particular, MnDOT has federally approved policies and procedures in their Right of Way Manual, specifically following MS 117 and MS 161 as well as federal law in the Code of Federal Regulation Title 49 Part 24; Title 23 Part 710; and the Uniform Act of 1970 with Amendments. Eligible fees and expenses are outlined within state and federal statutes.

<sup>9</sup> The League of Minnesota Cities provides an information memo on the statutory authority of cities to acquire real estate with references to Minnesota statutes, historical lawsuits and other information and resources. The memo is available at [http://www.lmc.org/media/document/1/purchase\\_and\\_sale\\_of\\_real\\_property.pdf?inline=true](http://www.lmc.org/media/document/1/purchase_and_sale_of_real_property.pdf?inline=true).

funding, the University of Minnesota<sup>10</sup> and legislative commissions, such as the Legislative-Citizen Commission on Minnesota Resources (LCCMR).<sup>11</sup>

Such a policy would not only be unwieldy, it would create significant confusion in reconciling a range of statutes. In so doing, the legislature could unintentionally undercut other important legislative goals. One example identified is the rules-based, fixed-rate pricing and publishing process of the BWSR's Reinvest in Minnesota (RIM) program, which provides fixed rates and transparency to the public.

Finally, several interviewees noted that, in addition to MnSCU, the intended scope of the legislation was to include non-exempt agencies—such the Departments of Health, Education and Corrections. However, such purchases are quite rare. When they do occur, the RECS division of the Department of Administration typically receives a specific appropriation from the legislature and conducts the purchase on their behalf.

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## RECOMMENDATION

The current scope of the legislation is clear and effectively narrow on its face. It applies to purchases made by MnSCU and to RECS in its capacity acting on behalf of other affected agencies with specific appropriations under MS 16B.31, subd. 5. It is recommended that this scope not be expanded to the exempted state agencies because a significant body of law exists for regulating their purchases.

Moreover, if the scope of MS 16B.297 is to be extended to any purchase using public money, it is further recommended that such action not be undertaken without thorough analyses of a complex array of other existing legislation regarding other political subdivisions of the state, non-government organizations and the University of Minnesota, which are too vast to be undertaken here.

## MAXIMUM PRICE

The statute establishes a maximum price ceiling of no more than 110 percent of the appraised value of the property.

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## FINDINGS

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### PRICE CAPS

The MnSCU system acquires between 5–15 properties in a typical fiscal year. RECS Division makes significantly fewer acquisitions (by specific appropriations) of real property interests for the benefit of other affected agencies. Most properties sought by MnSCU are adjacent to a college or university campus and are often opportunity purchases, meaning a seller approaches the college or university about selling their property or are otherwise acquired via voluntary, negotiated purchases with a seller. MnSCU purchases typically run the spectrum between residential, commercial and vacant land acquisitions.

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<sup>10</sup> The University of Minnesota has an established process for acquiring real estate. Maximum purchase price is generally defined by the average of two appraisals, both performed by a Member of the Appraisal Institute (MAI). The Board of Regents reviews every real estate purchase greater than \$1,250,000 or 10 acres. The University also reports proposed purchases to the chairs of Finance and Ways and Means prior to purchase for advisory review.

<sup>11</sup> The LCCMR makes its funding recommendations to the Legislature for special environment and natural resource projects, including the purchase of real property purchases. The LCCMR is subject to land acquisition restrictions under Minnesota Statutes 116P.15, which was revised in 2013. See <https://www.revisor.mn.gov/statutes/?id=116P>. See also, [www.lccmr.leg.mn](http://www.lccmr.leg.mn).

The appraised-value price cap<sup>12</sup> limits affected agency discretion in purchasing property and effectively moots the prior notification and review features of MS 136F.60. Proponents of the legislation asserted that this limitation on agency discretion, however, served an important purpose of signaling to sellers that they could not “hold out” for more money than the statute allows and may offer MnSCU and other affected agencies negotiating leverage with selling landowners.

Others thought that limiting agency discretion and substituting a price cap could have an unintended negative effect because all contingencies were not known. For example, a situation could arise where the state values the land higher than 110 percent of the appraised value and is willing to pay more rather than resorting to the time-consuming and sometimes adversarial nature of an eminent domain proceeding to acquire the property. Another interviewee felt that the prior review feature of existing regulation balanced agency discretion and prudent purchasing. In short, the price cap effectively eliminated discretion, without making a case that agencies were generally doing a poor job of managing public resources.

Interviewees were also divided on how much discretion this price cap actually provided to an affected agency. One view thought that the price cap was solely on the price paid for the real property or interest in real property.<sup>13</sup> In other words, an agency could offer up to 110 percent of the appraised value solely for the real property interest. Under this view, other directly related acquisition costs, such as appraisal fees, title fees closing costs and filing fees, could be paid for above and beyond the price cap.

Another view is that the price cap of no more than 110 percent of the appraised value was intended to include all other direct administrative costs of acquiring real property interest, such as filing fees, appraisals and title searches. The language of the statute is not clear to MMB on this point.

Regardless of what costs should be included in determining the maximum price, most interviewees could envision cases where an exception to the price cap should be entertained. Some thought that the statute itself did not provide sufficient discretion and thought that an unintended consequence of this statute would be that an eminent domain proceeding would follow a rejected agency offer. Still others stated that the legislature could work with agencies if a maximum price frustrated an agency’s ability to fulfill its mission.

One example of this was a case involving real property owned by US Steel on Lake Vermilion. In that case, the DNR—having been unsuccessful in acquiring this property—sought and secured special legislation allowing for its purchase. Other interviewees, while acknowledging that such a legislative option exists, noted that timing and other circumstances may render recourse to the legislature impractical or impossible.

Some interviewees remarked that the loss of agency discretion could be a hindrance in future property acquisitions where a capital improvement would normally follow the acquisition. In such cases it was urged that an exception to the purchase price requirement be granted if the overall cost of acquisition would be less. By way of example, this includes avoiding project costs in excess of the amount of the purchase price that exceeds the statutory cap. They advocated in effect that some form of case-by-case review of exceptions be

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<sup>12</sup> One interviewee thought that the adoption of an appraised value for the maximum price, rather than a county assessed value, would have a negative impact on surrounding private properties by raising their values. Under this view, the instant statute had the unintended impact of institutionalizing a state-purchasing model that would compound a challenge faced by many rural landowners, whereby state action was effectively increasing private property tax burdens. It was asserted that this is particularly acute for those citizens retired and living on fixed incomes in rural areas.

<sup>13</sup> One interviewee, commenting on the impact of a public sector purchase on property values and real estate taxes thought that the county assessed value, not the appraised value, be used as the maximum price ceiling for state purchases of real property. Further, additional direct costs in acquiring such property could also be expended by the agency.

drafted and adopted. Lacking such an option, the current statute could compel an agency to pursue property acquisition through eminent domain.

Finally, it was noted that an exception to the price cap rule should be allowable where the agency obtains two or more independent appraisals for the property and the appraisers' range of values vary more than 10 percent. While appraisers provide reasonable estimates of a property's worth, they may vary significantly from a seller or buyer's point of view. In such a case, there may be a need to provide an agency with more latitude in making an acceptable offer.

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## OTHER PRICE CONSIDERATIONS

Focusing on an agency's purpose in acquiring real property, several interviewees stated that once the property was acquired, the legislation did not take into account whether the purpose would require demolition of existing structures or remain undeveloped. In the former case, as in the case of Metropolitan State University, a vacant residence needed to be demolished as a necessary cost to make the land suitable for construction of a parking facility. This cost could, depending on negotiations, be included or excluded in the acquisition.<sup>14</sup>

The state also acquires land through means other than direct negotiation with the seller. Among other methods, organizations with similar missions regarding land acquisition will, at times, purchase land on the state's behalf or simply deed land over to the state for ongoing maintenance.<sup>15</sup> In these cases, the price to procure the land may be low relative to the cost of ongoing maintenance to sustain the property. Some interviewees were concerned that the mid- to long-term costs of real estate purchases under these circumstances required further examination.

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## RECOMMENDATIONS

1. The maximum price of 10 percent over appraised value means that an affected agency may offer up to 110 percent of the appraised value to pay for the cost of the property. MMB interprets this to mean that affected agencies may pay as much as 10 percent over the appraised value for the land. All other costs should be considered administrative costs and, if acceptable, may be incurred above and beyond the price paid for the real property interest.<sup>16</sup> This interpretation is consistent with the language of the statute. It also provides sellers with general guidance on what the maximum price an agency may offer and provides an affected agency with some degree of discretion.
2. Reducing agency discretion with a price cap should negate the need for prior review of pending purchases by the legislature under MS 136F.60 for MnSCU and MS 16B.335 for purchases made by RECS for other affected agencies. It is recommended that MS 136F.60 and the applicable notification clauses of MS 16B.335 be repealed.<sup>17</sup>
3. MS 16B.297 should be amended to permit an affected agency to seek an exception to the 110 percent of appraised value price cap. An intent of this statute was to provide a price ceiling for an

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<sup>14</sup> The University of Minnesota noted that it had been more successful specifying that the seller be responsible for demolition and reflecting that in the purchase price

<sup>15</sup> These organizations also receive state grants for land procurement.

<sup>16</sup> See Administrative Costs section at page 15.

<sup>17</sup> MS 16B.335 also specifically exempts a number of projects from the notification requirement. They range from hazardous waste to port development projects, as well as capital projects needed to comply with the Americans with Disabilities Act or funded by an agency's operating budget or asset preservation account, respectively under MS 16A.632 or MS 135A.046.

affected agency and an express limit to a seller. It was not to prompt more eminent domain proceedings. Nor does the statute necessarily take into account the intended use by the acquiring agency—the value of which could be significantly different (more or less) than the seller’s value. In such cases, additional factors need to be considered and weighed.

It is therefore recommended that the legislature identify a forum to which affected agencies could appeal. This forum could be comprised of a joint legislative-executive branch committee. Affected agencies seeking a maximum price exception would provide a fact sheet to this committee that would include, but not be limited to, authority for acquiring property interests, purpose of acquisition, relevant facts (e.g., demolition costs, relocation costs, forward-looking state investment), timetable for actions, description of efforts to date and appraised values.

Given that the scope of 16B.297 is narrow, the review burden would be likely be minimal. MnSCU, for instance, only undertakes 5–15 acquisitions per year.

In reviewing the appropriateness of the requested exception to purchase a property interest for more than the maximum price cap of 110 percent of appraised value, considerations for committee members could include:

- Whether and how the acquisition advances the affected agency’s legislative mission.
- Whether the overall cost to the affected agency in totality would be less if an exception was granted to the purchase price requirement.
- Whether the acquisition may have an unintended impact on surrounding property values.
- Whether and to what degree the affected agency is currently deferring maintenance or management of its existing property assets.

## **USE OF MS 82B APPRAISER; APPRAISALS OF LESS THAN \$100,000; NEW APPRAISAL DISCRETION**

Affected agencies are required to secure an appraisal conducted pursuant to and by someone licensed under MS 82B for the type of property to be purchased. To avoid conflicts of interest, the appraiser may not have a direct or indirect interest in the property being appraised.

If an affected agency’s appraisal is less than \$100,000 it may pay more than the 110 percent maximum price cap, so long as it is not more than the seller’s appraised value. Finally, an affected agency has the discretion to make a new appraisal.

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### **FINDINGS**

Interviewees were generally silent or in agreement with the requirement to use a licensed appraiser for the type of property to be purchased done in accordance with MS 82B. This also pertained to appraisals of less than 110 percent.

An interesting comment came, however, from one interviewee regarding agency discretion in seeking more than one appraisal. If more than one appraisal is conducted, the practical question that arises is which one should be used. The statute is silent on this point. It was recommended that an appraisal range of greater than 10 percent should result in an exception to the statute.

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### **RECOMMENDATIONS**

1. No exceptions are recommended for the required use of a MS 82B appraiser, doing an appraisal in accordance with MS 82B, nor with the requirement that the appraiser not have a direct or indirect interest in the property.
2. The flexibility provided to affected agencies for properties with appraised values of less than \$100,000 is acceptable. However, this fixed value may not be suitable in the future. Alternatives to

fixed costs in statute are to create ceilings or floors tied to some dynamic value. It is recommended that the legislature consider an alternative that provides a moving value. For example, one such value is a county's assessed value for property, which could provide an alternative option for affected agencies in some cases.

3. It is recommended that if an agency uses its discretion and undertakes a new appraisal, that the statute be interpreted as permitting the agency to offer up to 110 percent of the new appraisal.

## ADMINISTRATIVE COSTS

While MS 16B.297 and the above recommended exceptions are narrow in scope, the legislature has asked more broadly for comments and recommendations on “what information and documentation related to the parties’ administrative costs should be required before the state agrees to acquire real property or an interest in real property.”<sup>18</sup> MMB reads *parties* to include the seller and buyer to a real property interest transaction. Further, the costs under review—*administrative costs*—are not clearly defined or constant.

The topic of administrative costs is a subject of ongoing interest. In The Legislative Auditor’s evaluation report The Legacy Amendment<sup>19</sup> and MMB Guidance to Agencies on Legacy Fund Expenditure<sup>20</sup> the term administrative cost was defined with respect to funds expended pursuant to the Legacy Amendment.

The purpose of this section of the report is to build on these efforts and recommend definitions of administrative costs when acquiring interests in real property, needed documentation and criteria for incurring them.

## FINDINGS

Interviewees were divided on both the need for regulation of administrative costs and what administrative costs should be permissible.

Most interviewees cited purchase-related costs such as title fees, surveys, appraisals, closing costs and staff time as allowable administrative costs. Some interviewees included costs related to demolition (buyer need) and/or relocation (seller need). Others were unsure what the statute intended by the term administrative costs.

Others noted that they were less interested in costs that would normally be incurred by an agency anyway, such as staff time or related supplies costs, such as copying or mailings, and acknowledged the difficulty in knowing what costs are appropriate or worth considering. Another interviewee stated that the cost of recording land with a county, while necessary and directly related to the purchase of an interest in property, was of little concern.

When asked about inappropriate administrative costs, a few interviewees expressed concern that when the state acquires land through a third party, the state could be paying more than is necessary if the third party included some of its operational costs as a cost of acquiring the land.

In the course of acquiring real property, agencies incur administrative costs in addition to the cost of property. The relevant inquiries here are: what is the nature or purpose of the administrative costs, and should they be incurred?

There is currently no written standard on allowable administrative costs, though it has been subject to debate. In November 2011, the Office of the Legislative Auditor (OLA) issued an evaluation report entitled The Legacy Amendment.<sup>21</sup> In its report, the OLA included a general discussion about administrative costs as they relate to

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<sup>18</sup> See Laws of Minnesota 2014, chapter 304, section 2.

<sup>19</sup> Office of the Legislative Auditor. “Evaluation Report: The Legacy Amendment,” November 2011. Accessed January 2, 2015, <http://www.auditor.leg.state.mn.us/ped/2011/legacy.htm>.

<sup>20</sup> Minnesota Management & Budget. “MMB Guidance to Agencies on Legacy Fund Expenditures.” Accessed January 5, 2015, <http://www.mn.gov/mmb/images/Legacy%2520Fund%2520Guidance%25202012.pdf>.

<sup>21</sup> OLA, “The Legacy Amendment.”



administering government or other programs and identified common administrative costs.<sup>22</sup> The OLA report on the use of public funds for administrative costs is broader in scope than this report. The OLA, like interviewees for this report, recognized the importance of “finding a workable approach to limiting the use of public money for administrative costs.” Interviewees expressing similar concerns, however, were less certain about what constituted an administrative cost.

In the OLA report, the Legislative Auditor directed the Commissioner of MMB to provide guidance to state agencies in accounting for their Legacy Fund expenditures. The guidance developed by MMB on administrative costs in its report is instructive here.<sup>23</sup>

Administrative costs, unlike Generally Accepted Accounting Practice (GAAP) terms, are determined solely by context, making a universal definition unworkable. On the other hand, administrative costs are related to and often necessary in successfully completing an acquisition. MMB has identified four tiers of administrative costs:

- 1) Indirect costs (staff and copying);
- 2) Pre-acquisition, due diligence and transactional costs (variable and/or direct costs needed to finalize land purchase—e.g., buyer/seller costs);
- 3) Additional support costs incurred to secure real estate—e.g., legal, broker, consultants; and
- 4) Non-agency purchase costs (costs incurred by a third party and passed on to the agency as part of the total costs of acquiring the real property interest).

The first tier, indirect costs, is widely understood as necessary and requires little or no documentation. The other three warrant increasing levels of transparency, documentation and justification:

## INDIRECT COSTS

Common examples of administrative costs noted in the OLA Report and the MMB Guidance to Agencies include:<sup>24</sup>

- Accounting and Financial Services
- Clerical Support
- Executive and Supervisory Personal
- Facilities Management
- General Office Equipment and Supplies
- Human Resources
- Information Technology
- Insurance
- Legal Services
- Security

To the extent that any of the foregoing costs are widely understood and accepted as necessary, they were of little interest to interviewees. For example, information technology costs, general office supplies and staff hours may be used to support any and all land acquisitions, but the cost of tracking and reporting them was viewed as burdensome and irrelevant.

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<sup>22</sup> Common administrative costs identified by the Legislative Auditor include: accounting (and financial services), clerical support, executive and supervisory personnel, facilities management, general office equipment and supplies, human resources, information technology, insurance, legal services, purchasing, rent/lease, security, at page 53.

<sup>23</sup> MMB, “Legacy Fund Expenditures.”

<sup>24</sup> OLA, “The Legacy Amendment,” 53; MMB, “Legacy Fund Expenditures,” 3.

## PRE-ACQUISITION, DUE DILIGENCE AND TRANSACTIONAL COSTS

There are many pre-acquisition, due diligence and transactional costs that are relevant to the acquisition of real property. They are typically incurred in carrying out necessary due diligence to ensure that the property meets specific need requirements and that property ownership and its enjoyment are conveyed. Examples of these costs include:

- Title investigation costs (title commitment, abstract updates, title insurance)
- Land surveys
- Appraisals
- Environmental site assessments
- For improved properties (cost of facilities, condition assessment, and hazardous materials evaluation)
- Document recording fees
- Cost of appraisals
- Closing cost fee
- Demolition costs
- Relocation assistance

Interviewees recognized that on a case-by-case basis, there were reasons these costs were negotiable and could be incurred by either party to the transaction.

Policies regarding prior review processes, appraisals, maximum prices and identification of eligible costs for the direct or indirect purchase of real property or interests in real property have been developed by the DNR.<sup>25</sup>

## ADDITIONAL SUPPORT COSTS

When an affected agency is buying land directly from a seller, there are additional costs that may be incurred that are specific to the type of land and its intended use. In these cases, it may be necessary to hire additional support, such as real estate agents, lawyers, brokers and consultants.

Though additional support may not be necessary in all real estate acquisitions, these professionals can assist in purchasing property and add to the cost of purchase. For example, depending on the situation the state may seek assistance in evaluating the appropriateness of the property for a specific state purpose.

## NON-AGENCY PURCHASE COSTS

Of concern to some interviewees were third-party or non-government organization costs incurred in acquiring real property interests for the state. While MMB was unable to quantify the magnitude or frequency of these costs, it was stated anecdotally that these costs were more likely to be incurred in cases where the legislature provides grants to third parties through an agency, such as the DNR, to secure property interests for a public purpose.

Once acquired by a non-government organization, such property interests may be subsequently transferred to the state. To the extent that the third party or non-government organization includes any of its operating costs in fulfilling the terms of the grant, interviewees noted that third-party administrative costs were effectively included in the acquisition of real property interests on behalf of the state of Minnesota.

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<sup>25</sup> Memo from Kathy Lewis, Assistant Director to Division of Lands and Minerals Acquisition Staff, Department of Natural Resources, *Procedures for working with acquisitions acquired with grant dollars*, December 21, 2011; and *Guidance on Working with Non-Profit Land Trusts in Land Acquisitions*, February 10, 2012.

Some interviewees stated that this circumstance has come about because of a move in funding real property interest purchases through third-party grants. Others noted that fiduciary oversight under this approach was now one more step removed from the traditional agency-legislative review model and recommended that such purchases required more transparency.

## RECOMMENDATIONS

For purposes of acquiring interests in real property, four types of administrative costs should be recognized. Recommendations for each are listed below:

1. **Indirect costs.** Sunk costs are understood to be costs that an agency has already incurred, and is committed to paying regardless of its acquisition of an interest in real property. These include staff wages, copying, in-state travel and other day-to-day operational costs of an agency. It is recommended that agencies not be required to record these costs or submit them for prior review. These costs are administratively burdensome to track.
2. **Pre-acquisition, due diligence and transactional costs.** In situations where the state is purchasing property directly from the seller, an agency should identify all costs related to buyer needs, seller needs, variable costs and direct costs for which the state will be responsible. If these costs are typically paid by the seller, the state should justify its reason for covering such costs. If the real property needs to be altered (buyer need) or if relocation is needed (seller need), the affected agency should document costs and the reason for incurring those costs.
3. **Additional support costs.** If additional professional support is needed in securing real estate (legal, consultants, brokers) an agency buyer should document the cost of support and the reason support is necessary. These costs should be identified separately from the actual cost of the property interest. Additionally, documentation should reflect that support professionals have no conflict of interest in the transaction.
4. **Non-agency purchase costs.** In some cases purchases of real property are made with grant dollars by non-government organizations on behalf of the state, or ultimately on behalf of the state. Before the state or the grant-giving agency accepts acquisition, the non-government organization shall identify the source and dollars it paid to acquire the interest in real property, the pre-acquisition, due diligence and transaction costs, and any additional support costs it incurred. In addition, prior to acquiring an interest in non-agency purchased property, the state or acquiring agency shall provide an estimate of the ongoing costs it expects to incur in maintaining or managing the property for the next two fiscal years.

## APPENDIX 1

Minnesota Laws 2014, Chapter 304, states in its entirety:

### **Section 1. [16B.297] ACQUISITION OF REAL PROPERTY.**

Subd. 1. **Definition.** For the purposes of this section, “agency” means an agency as defined in section 16B.01, subdivision 2, and the Board of Trustees of the Minnesota State Colleges and Universities, but does not include the Department of Transportation, the Department of Natural Resources, or the Board of Water and Soil Resources.

Subd. 2. **Maximum price.** When an agency is authorized to acquire real property or an interest in real property with public money, the procedure in this section applies. The agency must first prepare a fact sheet providing a legal description of the real property to be acquired and the legal authority for its acquisition. The agency must obtain an appraisal of the real property by a person license under chapter 82B as an appraiser for the type of real property being appraised and the appraisal must be done in accordance with the requirements of chapter 82B. The appraiser shall not have an interest directly or indirectly in any of the real property being appraised. The agency may pay less for the property than the appraised value but must not agree to pay more than 10 percent above the appraised value. If the real property is appraised at less than \$100,000 by the agency and the seller, the agency may pay more than 110 percent of the agency’s appraised value but no more than the seller’s appraised value. New appraisals may be made at the discretion of the agency.

### **Section 2. REPORT.**

The commissioner of management and budget shall report by January 15, 2015, to the chairs and ranking minority members of the legislative committees with jurisdiction over policy and finance relating to real property acquisition by the state on what information and documentation related to the parties’ administrative costs should be required before the state agrees to acquire real property or an interest in real property. The commissioner, as part of the report, shall recommend whether exceptions to the requirements of Minnesota Statutes, section 16B.297, are necessary to protect the public interest, and make recommendations for appropriate exceptions, if any.

## APPENDIX 2

Federal and state laws governing DNR land acquisitions include:

- 42 U.S.C. 4601 to 4655 Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970
- MS 84.0272 Procedure in acquiring lands
- MS 84.0274 Landowners' Bill of Rights
- MS 84.0276 Land transfers by a federal agency
- MS 84.0277 Camp Ripley buffer easements
- MS 84.028, subd. 2 Overall coordination of acquisitions
- MS 84.029 Acquisition for trails
- MS 84.033 Acquisition for scientific and natural areas
- MS 84.085 General authority of Commissioner to accept gifts on behalf of the State
- MS 84.156, subd. 2 Acquisition of certain other titles
- MS 84.161 Acquisition for restoration and control of water levels of Goose and Mud Lake Cass County
- MS 84C and 84.64 Acquisition of conservation easements, conservation restrictions
- MS 84.66 Minnesota Forests for the Future Program
- MS 84.943–84.944 Acquisition of critical natural habitat
- MS 84.96 Native prairie bank
- MS 84A.10 Acquisition of lands in Red Lake Game Preserve
- MS 84A.29 Acquisition for reforestation areas and projects, 1931
- MS 84A.39 Acquisition for reforestation areas and projects, 1933
- MS 85.012 Acquisition for state parks
- MS 85.015 Acquisition for state trails
- MS 85.0155 Acquisition for Lake Superior Water Trail
- MS 85.021 Acquisition for Minnesota Valley Trail
- MS 85.32 Acquisition for state water trails
- MS 86A.07 Acquisition of units for the outdoor recreation system
- MS 88.09 Acquisition for fire protection
- MS 89.032 Acquisition for state forests
- MS 97A.056 Outdoor Heritage Fund acquisition requirements
- MS 97A.131 Acquisition for game farms and hatcheries
- MS 97A.135 Acquisition of wildlife lands
- MS 97A.141 Acquisition of public water access sites
- MS 97A.145 Acquisition of wetlands for wildlife
- MS 103F.331 Acquisition for wild and scenic rivers system
- MS 116P.15 Land acquisition restrictions (Environment and Natural Resources Trust Fund appropriations)
- MS 117.232 Landowner reimbursement for appraisal fees

The DNR is also subject to land acquisition requirements in Outdoor Heritage Fund and Environment and Natural Resources Trust fund appropriation laws. *See, e.g.*, Minn. Laws 2014 chapters 226 and 256. In addition, the DNR is subject to state and federal environmental laws.