

Arizona State Land Department Assessment of Department's agricultural leasing processes, groundwater reporting mechanisms, and Fondomonte's leases

Department's agricultural leasing process does not fully align with recommended practices; its agricultural leases including with Fondomonte are below market rates and do not require reporting of or payment for groundwater use; and it failed to adjust rental rates for 17 years resulting in more than \$3 million less in potential revenue in calendar year 2023

Special audit purpose

To address whether the Department's process for determining agricultural rental rates is aligned with peer states and best practices; appropriate reporting mechanisms for groundwater pumping especially by foreign leases; whether the contracts between Fondomonte Arizona, LLC (Fondomonte) and the Department provide lease costs for land and water below market rates; and whether the contracts between Fondomonte and the Department adequately address the issue of protecting water levels in the basin.

Key findings

- Department leases agricultural State trust land to generate revenue for trust beneficiaries, such as K-12 public schools. The Department has entered into 5 leases for agricultural State trust land in 2 groundwater basins in La Paz County with Fondomonte, a subsidiary of a company headquartered in Saudi Arabia
- Department processes for setting agricultural rental rates include some components of recommended practices we reviewed, such as valuing land. However, its processes do not fully align with all recommended practices, such as providing discounts based on the actual costs of lessee improvements. Additionally, Department processes are consistent with some peer states, but peer state practices vary.
- Department policy for establishing agricultural rental rates for farmable State trust land requires a mass appraisal to determine the land's market rental rate and to set farmable rental rates 50 percent below the market rental rate.
- Department failed to conduct a mass appraisal at least once every 10 years as required by statute, did not adjust rental rates over a 17-year period, and incorrectly charged some lessees, resulting in more than \$3.4 million less in potential revenue for trust beneficiaries in calendar year 2023.
- Our review of peer state and recommended practices did not identify relevant groundwater-pumping-reporting mechanisms, and the Department does not require foreign or domestic agricultural lessees to report groundwater use to it.
- Department agricultural leases, including with Fondomonte, provide lease costs for land below market rates, do not require payment for water use, and do not include provisions to protect water basin levels.

Key recommendations

The Department should:

- Conduct a mass appraisal of agricultural State trust land that complies with statutory requirements and update its agricultural rental rates accordingly.
- Consider and identify ways to align its agricultural leasing processes to recommended practices.