Report No. DODIG-2017-109

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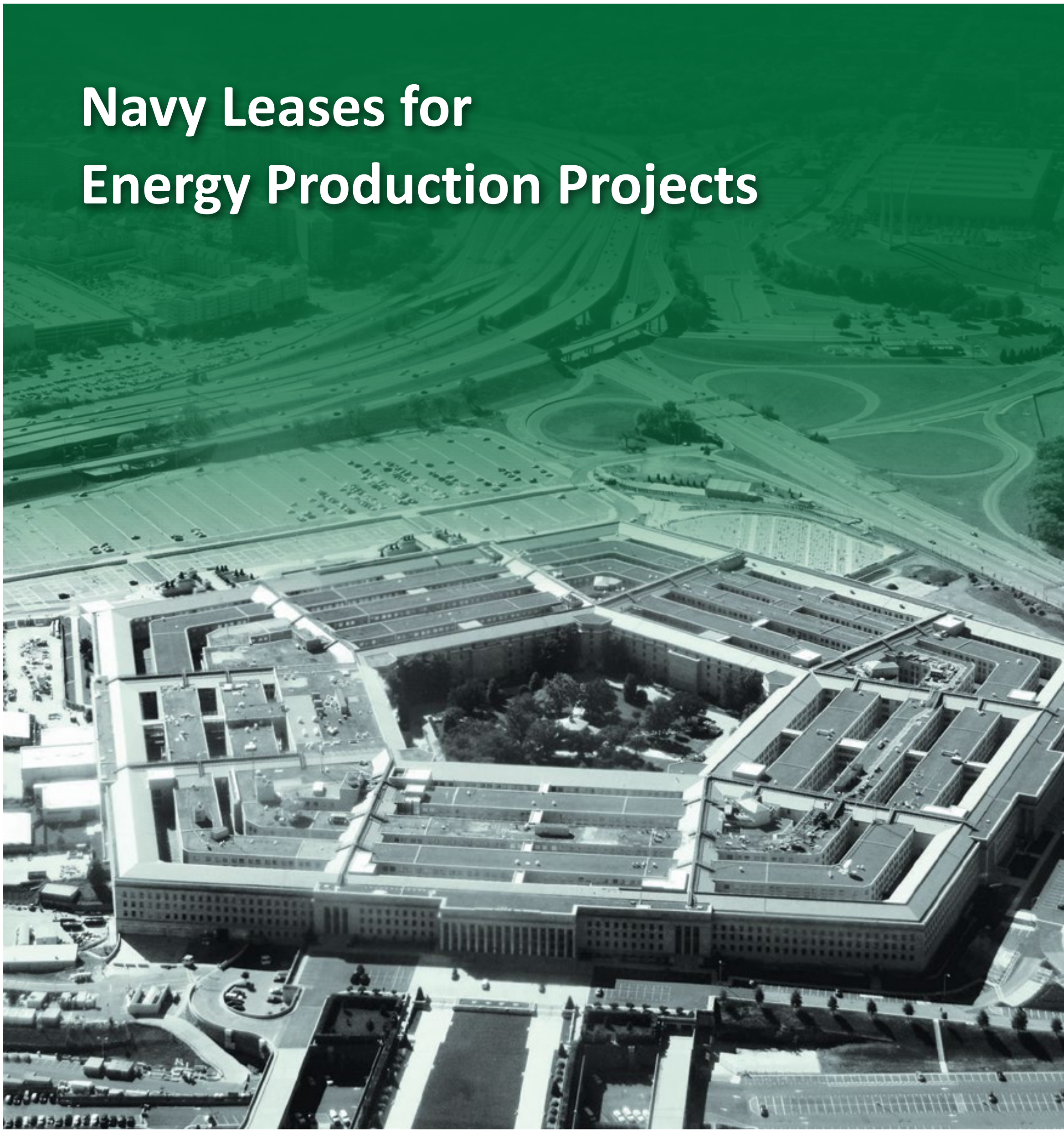
INSPECTOR GENERAL

U.S. Department of Defense

AUGUST 11, 2017

Navy Leases for Energy Production Projects



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Results in Brief

Navy Leases for Energy Production Projects

August 11, 2017

Objective

We determined whether the Department of the Navy properly awarded and obtained fair market value for leases supporting energy production projects.

We conducted this audit based on an allegation reported to the Defense Hotline. The allegation stated that the Army and Navy leased land to utility companies without using competitive procedures to select the lessee, and the Army and Navy are not receiving rent greater than or equal to the fair market value of the land. We previously audited Army leases supporting energy production projects in report DODIG-2016-137.

Background

The United States Code allows the Secretaries of the Military Departments to lease non-excess property when the Secretary determines that the property is not currently needed for public use, that the lease is advantageous to the United States, and that the lease will promote national defense or be in the public interest. The same statute requires that the Secretaries of the Military Departments use competitive procedures to select the lessees and that the lessees pay in cash or in-kind consideration greater than or equal to the fair market value of the leased property. In-kind consideration is nonmonetary compensation given as payment for the leased land.

As of October 5, 2016, the Navy executed 11 leases of real property in support of energy projects, and we selected 10 of those 11 leases for review. We did not review the remaining lease because a DoD OIG team reviewed it during a prior audit.

Finding

We determined that Navy Resilient Energy Program Office officials properly awarded the 10 leases reviewed supporting energy production projects in accordance with the United States Code. Specifically, Navy Resilient Energy Program Office officials issued solicitations, evaluated proposals, and obtained approval to award the leases.

In addition, the Navy will obtain fair market value for 10 leases supporting energy production projects if the Navy receives payment in the form of the agreed upon in-kind consideration. However, for 3 of the 10 leases, if the Navy does not receive payment in the form of in-kind consideration, the Navy will not receive cash payments greater than or equal to the fair market value of the land. This occurred because a Navy real estate contracting officer did not use the correct acreage to develop the rent schedule in two of the leases. For the third lease, the Navy real estate contracting officer modified the lease to increase the acreage but did not update the cash payment rent schedule. As a result, if the Navy does not receive payment in the form of in-kind consideration, the Navy will receive $290,000 less than the fair market value of the land.

Recommendations

We recommend that the Director, Navy Resilient Energy Program Office direct the real estate contracting officer to modify the Marine Corps Air Station Yuma, Arizona, lease to include the revised acreage or modify the lease to include a revised rent schedule developed using the acreage awarded in the lease. In addition, we recommend that the Director, Navy Resilient Energy Program Office direct the real estate contracting officer to modify the Marine Corps Logistics Base Albany, Georgia, and Naval Air Station Oceana, Virginia, leases to include a revised rent schedule developed using the acreage awarded in the lease. Furthermore, we recommend that the Director, Navy Resilient Energy Program Office, develop a process to ensure Navy real estate contracting officers update the lease rent schedule when Navy Resilient Energy Program Office officials revise the lease acreage.

Results in Brief

Navy Leases for Energy Production Projects

Management Comments and Our Response

The Commander, Naval Facilities Engineering Command, responding for the Director, Navy Resilient Energy Program Office, agreed with and implemented our recommendations as follows:

- the real estate contracting officer modified the Marine Corps Air Station Yuma, Arizona, lease to include the revised acreage;
- the real estate contracting officer modified the Marine Corps Logistics Base Albany, Georgia, and Naval Air Station Oceana, Virginia, leases to include the revised rent schedule developed using the acreage awarded in the lease; and
- the Acting Deputy Director, Navy Resilient Energy Program Office, disseminated to Navy real estate contracting officers instructions for updating the lease rent schedule when Navy Resilient Energy Program Office officials revise the lease acreage.

The management actions taken during the audit fully addressed the specifics of the recommendations and we consider the recommendations closed. Please see the Recommendations Table on the next page for the status of the recommendations.

Recommendations Table

Management	Recommendations Unresolved	Recommendations Resolved	Recommendations Closed
Director, Navy Resilient Energy Program Office	None	None	1.a, 1.b, 1.c

Note: The following categories are used to describe agency management's comments to individual recommendations.

- **Unresolved** – Management has not agreed to implement the recommendation or has not proposed actions that will address the recommendation.
- **Resolved** – Management agreed to implement the recommendation or has proposed actions that will address the underlying finding that generated the recommendation.
- **Closed** – OIG verified that the agreed upon corrective actions were implemented.

INSPECTOR GENERAL

INTEGRITY EFFICIENCY

DEPARTMENT OF DEFENSE

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August 11, 2017

MEMORANDUM FOR NAVAL INSPECTOR GENERAL

SUBJECT: Navy Leases for Energy Production Projects (Report No. DODIG-2017-109)

We are providing this final report for your information and use. Navy Resilient Program Office officials properly awarded the 10 leases reviewed supporting energy production projects in accordance with the United States Code. In addition, the Navy will obtain fair market value for 10 leases if the Navy receives payment in the form of the agreed upon in-kind consideration. However, for 3 of the 10 leases, if the Navy does not receive payment in the form of in-kind consideration, the Navy will not receive cash payments greater than or equal to the fair market value of the land. We conducted this audit in accordance with generally accepted government auditing standards.

We considered comments on a draft of this report. DoD Instruction 7650.03 requires that recommendations be resolved promptly. Comments from the Commander, Naval Facilities Engineering Command, agreed with our recommendations. The management actions taken during the audit addressed the specifics of the recommendations; therefore, no further comments are required and the recommendations are closed. We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 604-9187 (DSN 664-9187).

Michael J. Roark
Assistant Inspector General
Contract Management and Payments

Contents

Introduction

Objective

We determined whether the Department of the Navy properly awarded and obtained fair market value for leases supporting energy production projects. This is the second audit related to leases supporting energy production projects. See Appendix A for a discussion of the scope, methodology, and prior coverage.

We conducted this audit based on an allegation reported to the Defense Hotline. The allegation stated the Army and Navy leased land to utility companies without using competitive procedures to select the lessee and that the Army and Navy are not receiving rent greater than or equal to the fair market value of the land as required by section 2667, title 10, United States Code (10 U.S.C. § 2667 [2015]). According to 10 U.S.C. § 2667 (2015), the Secretaries of the Military Departments can lease non excess property under their control when the Secretary determines that the property is not currently needed for public use, that the lease is advantageous to the United States, and that the lease will promote national defense or be in the public interest. To select the lessee, the same statute requires that the Secretaries use competitive procedures unless the Secretary determines that a public interest will be served as a result of the lease and the use of competitive procedures for the selection of certain leases is unobtainable. In addition, the lessees should pay in cash or in-kind consideration (IKC) greater than or equal to the fair market value of the leased land.[1] We partially substantiated the allegation that the Navy did not use competitive procedures to select the lessee. We partially substantiated the allegation that the Navy did not receive rent greater than or equal to the fair market value of the leased land.

Background

In 2011, the United States Code established a goal for the DoD to produce or procure not less than 25 percent of its total energy consumption within its facilities from renewable energy sources by 2025.[2] Renewable energy is generated from sources such as solar and wind. In October 2009, the Secretary of the Navy established a goal to produce 50 percent of the Navy's energy from alternative sources by 2020.[3] The Navy established this goal to improve energy security. According to 10 U.S.C. § 2924 (2011), energy security is defined as having assured access to reliable supplies of energy and the ability to protect and deliver sufficient

1 IKC is nonmonetary compensation given as payment for the leased land such as construction of new facilities or payment of utility services.

2 10 U.S.C. § 2911 (2011).

3 Deputy Assistant Secretary of the Navy for Energy memorandum, "Secretary of the Navy Shore Energy Policy," December 1, 2011.

energy to meet mission essential requirements. In May 2014, the Secretary of the Navy established the Renewable Energy Program Office, which is the central management office for Navy renewable energy. On December 31, 2016, the Assistant Secretary of the Navy for Energy, Installations, and Environment changed the name of the Renewable Energy Program Office to the Resilient Energy Program Office (REPO). The Navy REPO identifies renewable energy projects to help fulfill the Secretary of the Navy's goals and to support statutory and policy mandates for energy.

Navy Renewable Energy

The Navy is pursuing renewable energy generation using the following three models:

- Model 1 — Navy purchases renewable energy from an off-base generation source for on-base consumption;
- Model 2 — Navy leases on-base land to a third party to generate energy on-base for off-base consumption; and
- Model 3 — Navy purchases renewable energy from a third-party–operated, on-base generation source for on-base consumption.

We reviewed Model 2 projects because they included Navy leases, and leases were the focus of the allegation. Figure 1 shows a Model 2 project with solar panels at Naval Submarine Base Kings Bay, Georgia, and Figure 2 shows a Model 2 project with solar panels at Marine Corps Base Camp Lejeune, North Carolina.

Figure 1. Solar Panels at Naval Submarine Base Kings Bay, Georgia
Source: Naval Facilities Engineering Command Southeast.

Figure 2. Solar Panels at Marine Corps Base Camp Lejeune, North Carolina
Source: Marine Corps Base Camp Lejeune Public Works Office.

Responsibilities of Navy Components in the Lease Award Process for Model 2 Projects

The following Navy Components are responsible for awarding leases for Model 2 projects.

- The Office of Assistant Secretary of the Navy for Energy, Installations, and Environment generated the initial requirement for Model 2 projects and approved each project prior to lease award.[4]
- Navy and Marine Corps installations identified the land on the installation.
- Navy REPO and Naval Facilities Engineering Command (NAVFAC) officials managed the projects, which included preparing and releasing the solicitations and evaluating proposals.[5]
- NAVFAC officials appraised the leased land to determine the fair market value of the land.
- The Navy real estate contracting officer awarded the lease.

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4 The Office of Assistant Secretary of the Navy for Energy, Installations, and Environment develops and oversees Navy policy matters pertaining to energy initiatives, including shore energy initiatives.

5 NAVFAC builds and maintains facilities and delivers utilities and services to Navy and Marine Corps installations.

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Navy Leases Reviewed

As of October 5, 2016, the Navy executed 11 Model 2 leases in support of energy projects. We eliminated one Model 2 lease because a DoD Office of Inspector General (DoD OIG) team reviewed it during a previous audit.[6] Therefore, we reviewed 10 leases at 10 Navy and Marine Corps installations. See Table 1 for the leases selected for review.

Table 1. Leases Selected for Review

Installation	Date Awarded	Acreage	Lease Term (in years)	Project Description
MCB Camp Lejeune, North Carolina	February 2015	81.1	25	13 MW Solar
NSB Kings Bay, Georgia	July 2015	254.3	37	30 MW Solar
MCAS Yuma, Arizona	October 2015	2.5	32	25 MW Generators
NAS Whiting Field OLF Holley, Florida	October 2015	311.3	37	40 MW Solar
NAS Pensacola OLF Saufley, Florida	October 2015	450.0	37	50 MW Solar
NSA Crane, Indiana	December 2015	140.5	30	23 MW Solar
MCLB Albany, Georgia	December 2015	153.8	37	26 MW Solar
NCBC Gulfport, Mississippi	January 2016	23.9	31	3 MW Solar
NSA Mid-South, Tennessee	April 2016	72.0	37	52 MW Solar
NAS Oceana, Virginia	July 2016	98.4	37	18 MW Solar

Source: DoD OIG.

Legend

MCAS Marine Corps Air Station

MCB Marine Corps Base

MCLB Marine Corps Logistics Base

MW Megawatt

NAS Naval Air Station

NCBC Naval Construction Battalion Center

NSA Naval Support Activity

NSB Naval Submarine Base

OLF Outlying Landing Field

6 Report No. DODIG-2016-130, "The Navy Needs More Comprehensive Guidance for Evaluating and Supporting Cost-Effectiveness of Large-Scale Renewable Energy Projects," August 25, 2016.

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Review of Internal Controls

DoD Instruction 5010.40 requires DoD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the effectiveness of the controls.[7] The Navy REPO did not use the correct acreage to develop the rent schedule in two leases. For a third lease, the Navy real estate contracting officer modified the lease to increase the acreage, but did not update the cash payment rent schedule. In addition, the Navy REPO did not have a process to ensure Navy real estate contracting officers updated the lease rent schedule when Navy REPO officials adjusted the lease acreage. We will provide a copy of the report to the senior official responsible for internal controls at the Navy Resilient Energy Program Office.

[7] DoD Instruction 5010.40, "Managers' Internal Control Program Procedures," May 30, 2013.

Finding

Navy Resilient Energy Program Office Officials Properly Awarded 10 Leases, but for 3 Leases, the Navy May Not Obtain Fair Market Value for the Land

Navy REPO officials properly awarded the 10 leases we reviewed supporting energy production projects in accordance with 10 U.S.C. § 2667 (2015) provisioning leases of non-excess property. Specifically, Navy REPO officials issued solicitations, evaluated proposals, and obtained approval to award the leases.

The Navy will obtain fair market value for the 10 leases supporting energy production projects if the Navy receives payment in the form of the agreed upon in-kind consideration (IKC). However, for 3 of the 10 leases, if the Navy does not receive payment in the form of IKC, the Navy will not receive cash payments greater than or equal to the fair market value of the land.[8] This occurred because the Navy real estate contracting officer did not use the correct acreage to develop the cash payment rent schedule in two of the leases. For the third lease, the Navy real estate contracting officer modified the lease to increase the acreage but did not update the cash payment rent schedule. As a result, if the Navy does not receive payment in the form of IKC, the Navy will receive $290,000 less than the fair market value of the land.

Navy REPO Properly Awarded 10 Leases

Navy REPO officials properly awarded the 10 leases we reviewed supporting energy production projects in accordance with the United States Code.[9] Specifically, Navy REPO officials issued solicitations, evaluated proposals, and obtained approval to award the leases in accordance with section 2667.

Navy REPO Officials Issued Solicitations

Navy REPO officials properly issued solicitations for the 10 leases we reviewed. According to United States Code, Navy officials must award leases through competitive procedures unless the Secretary determines that a public interest will be served as a result of the lease and the use of competitive procedures for the selection of certain leases is unobtainable.[10] Navy guidance states that Navy

8 If the government does not receive the IKC in full within 3 years, cash payments are due for the 3 years and the remaining term of the lease.

9 10 U.S.C. § 2667 (2015).

10 10 U.S.C. § 2667 (2015).

officials should award leases through a competitive process consistent with current market conditions and sound business practices unless the Commander, NAVFAC, determines that there is only one available lessee or that leasing to a selected lessee can be fully justified as being in the best interests of the Government. Navy REPO officials issued solicitations for the 10 leases we reviewed. Navy REPO officials stated in the solicitations that they would select a single offeror for the exclusive negotiation of a lease of the site. For 6 of the 10 leases we reviewed, Navy REPO officials publicized the solicitations on Federal Business Opportunities.[11] In addition, Navy REPO officials issued the solicitations to the local utility company for each of the four remaining leases.

Navy REPO Officials Publicized Six Solicitations on Federal Business Opportunities

For 6 of the 10 leases we reviewed, Navy REPO officials publicized solicitations on Federal Business Opportunities.[12] Navy REPO officials independently issued solicitations for five leases.[13] However, for the NSA Mid-South lease, Navy REPO officials worked with the Tennessee Valley Authority, which is a corporate agency of the United States, to solicit the lease at NSA Mid-South. The NSA Mid-South solicitation included the Navy REPO lease requirement and the Tennessee Valley Authority power purchase agreement requirement.[14] Navy REPO leased the land to the third-party utility company.[15]

For 6 of the 10 leases we reviewed, Navy REPO officials publicized solicitations on Federal Business Opportunities.

The solicitations for the five leases included a description of the requirement, information required in the offeror's proposal, and factors used to evaluate the proposal. For example, Navy REPO officials stated in the solicitations that they will evaluate proposals based on the:

- technical proposal;
- business proposal; and
- IKC proposal.

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[11] Federal Business Opportunities is a Government website used for advertising all Federal procurement opportunities over $25,000.

[12] MCLB Albany, NAS Pensacola OLF Saufley, NAS Whiting Field OLF Holley, NSA Crane, NCBC Gulfport, and NSA Mid-South.

[13] MCLB Albany, NAS Pensacola OLF Saufley, NAS Whiting Field OLF Holley, NSA Crane, and NCBC Gulfport.

[14] A power purchase agreement is also referred to as a renewable energy services agreement.

[15] Specifically, the power purchase agreement is the agreement for Tennessee Valley Authority to purchase power generated at NSA Mid-South by the lessee, which is a third-party utility company.

The solicitation for NSA Mid-South included a description of the Navy lease requirement and a link to the Tennessee Valley Authority solicitation for the power purchase agreement, which included the Navy lease requirement. The solicitation also included the information required in the offeror's proposal and factors used to evaluate proposals. For example, the solicitation stated that the proposal must include a technical description of IKC and cash payments to the Navy that are greater than or equal to the fair market value of the land.

Navy REPO Officials Issued a Solicitation for Leases at Four Installations

For 4 of the 10 leases we reviewed, Navy REPO officials awarded the leases in accordance with 10 U.S.C. § 2667 (2015), but incorrectly categorized the leases as being awarded using a competitive process.[16] Specifically, Navy REPO officials determined that only one local utility company for each of the four installations could meet lease requirements. According to Navy REPO officials, they satisfied competitive requirements under the United States Code for these four leases through market and physical infrastructure surveys.[17] We disagree that the procedures used by Navy REPO officials were competitive.

For the four leases, Navy REPO officials determined that there was only one available lessee by conducting market and physical infrastructure surveys. Specifically, Navy REPO officials' market and physical surveys at four installations identified the local utility as the only entity legally allowed to control electricity and physically control distribution to the installation. Navy REPO officials worked with the Department of Energy, the National Renewable Energy Laboratory, and the local utility company to evaluate entities legally allowed to distribute electricity near the installations. Navy REPO officials also conducted physical infrastructure surveys of electricity distribution lines serving the installation.

For the four leases, Navy REPO officials determined that there was only one available lessee by conducting market and physical infrastructure surveys.

After Navy REPO officials determined that there was only one available lessee, Navy REPO officials issued a solicitation directly to the one local utility company for each of the four installations. Navy REPO officials required that the utility companies' response to the solicitation include a signed certification statement confirming they were the only entity legally allowed to control electricity distribution to the installation. For example, the local utility companies at

[16] MCB Camp Lejeune, NSB Kings Bay, NAS Oceana, and MCAS Yuma.

[17] 10 U.S.C. § 2667 (2015).

MCB Camp Lejeune, NSB Kings Bay, NAS Oceana, and MCAS Yuma signed the certification statement confirming they were the only entity legally allowed to control electricity distribution to the installation.

Navy REPO officials incorrectly categorized the four leases as being awarded using a competitive process. Navy REPO officials explained their competitive procedures as follows:

> Specific to the ten REPO Model 2 leases, the market/physical infrastructure surveys and subsequent solicitations complied with the competitive procedure requirement of 2667 [10 U.S.C. § 2667 (2015)]. Where the market/physical infrastructure surveys conclusively demonstrated that there was only one available respondent (which was the case at Lejeune, Kings Bay, Oceana, and Yuma), the project team conferred with the Office of the Assistant Secretary of the Navy for Energy, Installations and Environment, and there was mutual agreement that the surveys in combination with a subsequent solicitation was sufficient competitive procedure. This determination is found in each project approval package.

However, Navy REPO officials issued the solicitation to only one local utility company for each of the four installations, which did not constitute a competitive procedure. Although undefined in the United States Code and Navy guidance,[18] we understand a competitive procedure to provide the opportunity for competition between companies.[19] Because the market and physical surveys that Navy REPO officials conducted determined that there was only one available lessee, competition between utility companies was effectively unobtainable, and Navy REPO officials should have awarded the leases under other than competitive procedures as contemplated and expressly authorized by both United States Code and Navy guidance.[20]

If Navy REPO officials awarded the four leases under other than competitive procedures, Navy REPO officials would have awarded the leases to the same utility companies for each of the four leases. Additionally, in Navy guidance, the Secretary delegated to the Commander, NAVFAC or his or her designees the authority to determine there is

Navy REPO officials would have awarded the leases to the same utility companies for each of the four leases.

[18] 10 U.S.C. § 2667 (2015) and NAVFAC P-73 "Real Estate Procedural Manual."

[19] We find useful the following guidance from a decision of the United States Court of Appeals for the Federal Circuit:

> "[W]e may refer to dictionary definitions to determine the ordinary meaning of an undefined statutory term . . . . "Competitive" is defined as "characterized by, arising from, or designated to exhibit rivalry among two or more equally matched individuals or forces especially for a particular goal, position or reward," and as "involving, or determined by competition." See Res–Care, 107 Fed. Cl. at 141 (quoting Webster's II New Riverside Univ. Dict. 290 (1984))." (*Res-Care, Inc. v. United States*, 735 F.3d 1384, 1388 (Fed. Cir. 2013)).

[20] 10 U.S.C. § 2667 (2015) and NAVFAC P-73 "Real Estate Procedural Manual."

only one available lessee in order to support leasing by other than competitive means.[21] Since the NAVFAC project approval packages for the four leases include findings that only one lessee was available,[22] we conclude that the requirements of 10 U.S.C. § 2667 (2015) were satisfied even though Navy REPO officials incorrectly categorized the leases as awarded using competitive procedures.[23] Therefore, we are not making a recommendation.

Navy REPO Officials Properly Evaluated Proposals

Navy REPO officials properly evaluated offerors' proposals for the 10 leases reviewed.

Navy REPO officials properly evaluated offerors' proposals for the 10 leases reviewed. Specifically, Navy REPO officials evaluated the offerors' proposals based on the evaluation factors outlined in the solicitations. For 5 of the 10 leases, Navy REPO officials evaluated a single offeror for each individual lease.[24] Based on their evaluation of the proposals, Navy REPO officials selected the single offerors for each of the leases to participate in exclusive negotiations of the leases with the Navy.

According to a Navy REPO official, they evaluated four proposals for the NSA Mid-South lease to determine whether the offerors' proposals addressed the Navy lease requirement. Specifically, a Navy REPO official stated that they reviewed the offerors' descriptions to meet the payment requirement for the land in IKC or cash payments to the Navy that is greater than or equal to the fair market value of the land. A Navy REPO official stated that the Tennessee Valley Authority made the final selection for the power purchase agreement and the Navy REPO entered into exclusive negotiations of a lease of the land at Mid-South with the selected offeror.

The local utility companies at MCB Camp Lejeune, NSB Kings Bay, NAS Oceana, and MCAS Yuma signed the certification statement confirming they were the only entity legally allowed to control electricity distribution to the installation. Therefore, the Navy REPO entered into exclusive negotiations of a lease for the land at the installations.

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21 NAVFAC P-73, "Real Estate Procedural Manual."

22 The NAVFAC Assistant Commander for Asset Management signed each project package.

23 Since Navy REPO officials did not process the leases using Navy's non-competitive procedures, we did not review and we do not conclude that Navy REPO officials met all Navy requirements for leasing by other than competitive means.

24 MCLB Albany, NAS Pensacola OLF Saufley, NAS Whiting Field OLF Holley, NSA Crane, and NCBC Gulfport.

Navy REPO Officials Obtained the Approval to Execute 10 Leases

Navy REPO officials received approval to execute the 10 leases reviewed. Navy guidance states that all leases that have a term longer than 5 years require the approval from the Deputy Assistant Secretary of the Navy (Installations and Facilities). Navy REPO officials provided the Principal Deputy Assistant Secretary of the Navy for Energy, Installations, and Environment a package that included:

- site approval from the installation,
- project technical information,
- value of IKC, and
- rent schedule.

The Principal Deputy Assistant Secretary of the Navy for Energy, Installations, and Environment granted approval for Navy REPO officials to award the 10 leases reviewed.

The Navy May Not Obtain Fair Market Value for the Land for 3 of 10 Leases

For 3 of the 10 leases we reviewed, the Navy may not obtain fair market value for the land. According to the United States Code, the lessee must submit payment in cash or IKC in an amount greater than or equal to the fair market value of the leased land.[25] NAVFAC officials properly determined the fair market value of the leased land at 10 installations. The Navy will obtain fair market value for the 10 leases if the Navy receives payments in the form of the agreed upon IKC. However, for 3 of the 10 leases, if the Navy does not receive payment in the form of IKC, the Navy will not receive cash payments greater than or equal to the fair market value of the land.

NAVFAC Officials Properly Determined the Fair Market Value of the Land

NAVFAC officials properly determined the fair market value of the leased land at 10 installations. Navy guidance requires an appraisal to determine the fair market value of Navy real property proposed for a lease and requires that appraisals conform to the Uniform Standards of Professional Appraisal Practice.[26] NAVFAC officials prepared the appraisals for the land at the 10 installations in accordance with the Uniform Standards of Professional Appraisal Practice.

NAVFAC officials properly determined the fair market value of the leased land at 10 installations.

[25] 10 U.S.C. § 2667 (2015).

[26] The Uniform Standards of Professional Appraisal Practice is the generally accepted standard for all appraisers in the United States.

For the 10 leases we reviewed, rent will accrue for the first 3 years of the term, and at the end of the 3-year accrual period the lessee must provide IKC in full. If the Government does not receive the IKC in full, cash payments are due for the 3 years of accrued rent and the remaining term of the lease. Since the Navy would receive the IKC in full at the end of the 3-year accrual period, Navy REPO officials used the net present value of total rent due over the lease term as the fair market value for IKC.[27, 28] If the Government does not receive the IKC in full, the lessee must pay the yearly cash rent in accordance with the rent schedule included in the lease. According to Navy REPO officials, the rent schedule in the leases ensures that the Navy receives cash payment greater than or equal to the fair market value of the land if they do not receive the IKC.

The Navy Will Receive Payments Greater Than or Equal to the Fair Market Value for 10 Leases if the Navy Receives IKC

The Navy will obtain fair market value for the 10 leases ... if the Navy receives payment in the form of the agreed upon IKC.

The Navy will obtain fair market value for the 10 leases supporting energy production projects if the Navy receives payment in the form of the agreed upon IKC. According to the United States Code, acceptable forms of IKC include, among others, improvement of facilities, construction of new facilities, and provision of other services related to activities that will occur on the leased property as the Secretary of the Navy considers appropriate.[29] For the 10 leases, the Navy will receive IKC in the form of utility infrastructure upgrades or a combination of utility infrastructure upgrades and access to the power generated on the leased land during a regional outage.[30] Navy REPO officials valued the hardware associated with the infrastructure upgrades and used the utility companies' rates for standby power to value the access to the power generated on the leased land during a regional outage. According to an official from the Office of the Assistant Secretary of Defense for Energy, Installations, and Environment, the Navy REPO methodologies for valuing access to the power during a regional outage is acceptable and complies with the definition of energy security in 10 U.S.C. § 2924 (2011) (see page 1 for definition of energy security).

27 ~~(FOUO)~~ The Navy used a [redacted] discount rate to calculate the net present value of the total rent due. The net present value of the total rent due averaged 122 percent greater than the appraised value of the land if sold at the 10 installations.

28 ~~(FOUO)~~ For example, for the NCBC Gulfport lease the lessee is required to pay [redacted] in cash over the 31-year term of the lease. The net present value of [redacted] is [redacted]; therefore, prior to the end of the 3-year accrual period, the lessee can satisfy the payment in IKC if the IKC is valued at or greater than [redacted].

29 10 U.S.C. § 2667 (2015).

30 Access to the power generated on the leased land during a regional outage gives the Navy energy security.

~~(FOUO)~~ For 5 of the 10 leases, the installations will receive IKC in the form of utility infrastructure upgrades.[31] For example, the fair market value for IKC at NAS Oceana is [redacted]. The hardware associated with the infrastructure upgrades is valued at [redacted]. Therefore, NAS Oceana will receive IKC valued at [redacted] greater than the fair market value of the land.

~~(FOUO)~~ For 5 of the 10 leases, the installations will receive IKC in the form of a combination of utility infrastructure upgrades and access to the power generated on the leased land during a regional outage.[32] For example, the NSB Kings Bay fair market value for IKC is [redacted]. Navy REPO officials valued NSB Kings Bay's access to power during a regional outage at [redacted]. The hardware associated with the infrastructure upgrades is valued at [redacted]. Therefore, NSB King's Bay will receive IKC valued at [redacted], which is [redacted] greater than the fair market value of the land. See Appendix B, Table 2 for the comparison of the fair market value for payment in IKC and the value of the IKC.

The Navy Will Not Receive Payments Greater Than or Equal to the Fair Market Value for 3 of 10 Leases if the Navy Does Not Receive IKC

~~(FOUO)~~ For 3 of the 10 leases we reviewed, if the Navy does not receive payment in the form of IKC, the Navy will not receive cash payments greater than or equal to the fair market value of the land. Specifically, the Navy will not receive cash payments greater than or equal to the fair market value of the land at MCAS Yuma, MCLB Albany, and NAS Oceana. For example, for the MCAS Yuma lease, the Navy must receive [redacted] in cash payments over the lease term to obtain fair market value for the land. However, according to the MCAS Yuma lease rent schedule, the Navy will receive [redacted] in cash payments over the lease term. Therefore, the Navy will not receive [redacted][33] in rent payments for the land at MCAS Yuma. In addition, for the MCLB Albany lease, the Navy must receive [redacted] in cash payments over the lease term to obtain fair market value for the land. However, according to the MCLB Albany lease rent schedule, the Navy will receive [redacted] in cash payments over the lease term. Therefore, the Navy will not receive [redacted] in rent payments for the land at MCLB Albany. Furthermore, for the NAS Oceana lease, the Navy must receive [redacted] in cash payments over the lease term to obtain fair market value for the land. However, according to the NAS Oceana lease rent schedule, the Navy will receive [redacted] in cash

[31] NAS Whiting Field OLF Holley, NAS Oceana, NSA Crane, NSA Mid-South, and NAS Pensacola OLF Saufley.

[32] MCB Camp Lejeune, NSB Kings Bay, NCBC Gulfport, MCAS Yuma, and MCLB Albany.

[33] ~~(FOUO)~~ Rent payments total [redacted] and the fair market value of the land totals [redacted]. The [redacted] is a rounded amount.

~~(FOUO)~~ payments over the lease term. Therefore, the Navy will not receive [redacted][34] in rent payments for the land at NAS Oceana. See Appendix B, Table 3 for the comparison of the fair market value for payment in cash and the total rent due in the lease rent schedule.

Navy REPO Officials Did Not Properly Develop or Update the Rent Schedule

The Navy real estate contracting officer did not use the correct acreage to develop the rent schedule in the MCAS Yuma lease. Specifically, for the MCAS Yuma lease, the Navy real estate contracting officer developed the lease rent schedule using 1 acre of land instead of the 2.5 acres awarded in the lease. According to the Navy real estate contracting officer, they included the incorrect acreage in the awarded lease; the correct acreage should have been 1 acre of land instead of the 2.5 acres awarded in the lease. Therefore, the Navy real estate contracting officer should modify the MCAS Yuma lease to include the revised acreage or modify the MCAS Yuma lease to include a revised rent schedule developed using the acreage awarded in the leases.

In addition, the Navy real estate contracting officer did not use the correct acreage to develop the rent schedule for the MCLB Albany lease and did not update the rent schedule for the NAS Oceana lease. For the MCLB Albany lease, the Navy real estate contracting officer developed the lease rent schedule using 150 acres of land instead of the 153.8 acres awarded in the lease. Furthermore, for the NAS Oceana lease, the Navy real estate contracting officer modified the lease to increase the acreage, but did not update the cash payment rent schedule. Specifically, for the NAS Oceana lease, the Navy real estate contracting officer modified the lease in March 2017 to increase the acreage by 3 acres. However, the Navy real estate contracting officer did not update the cash payment rent schedule to reflect the 98.4 acres in the modified lease.[35] Therefore, the Navy real estate contracting officer should modify the MCLB Albany and NAS Oceana leases to include a revised rent schedule developed using the acreage awarded in the leases. In addition, Navy REPO officials should develop a process to ensure Navy real estate contracting officers update the lease rent schedule when Navy REPO officials adjust the lease acreage.

[34] ~~(FOUO)~~ Rent payments total [redacted] and the fair market value of the land totals [redacted]. The [redacted] is a rounded amount.

[35] The Navy real estate contracting officer originally awarded 95.4 acres in the NAS Oceana lease.

The Navy May Receive Less Than Fair Market Value for the Land

As a result, the Navy may not receive fair market value for the leased land for three leases we reviewed. Specifically, if the Navy does not receive payment in the form of IKC for the leases, the Navy will receive $290,000 less than the fair market value of the land. In addition, the Navy may not meet the United States Code requirement for lessees to pay in cash or IKC greater than or equal to the fair market value of the leased land.[36]

If the Navy does not receive payment in the form of IKC ... the Navy will receive $290,000 less than the fair market value.

Recommendations, Management Comments, and Our Response

Recommendation 1

We recommend the Director, Navy Resilient Energy Program Office:

a. **Direct the real estate contracting officer to modify the Marine Corps Air Station Yuma lease to include the revised acreage or modify the lease to include a revised rent schedule developed using the acreage awarded in the lease.**

Navy Resilient Energy Program Office Comments

The Commander, Naval Facilities Engineering Command, responding for the Director, Navy Resilient Energy Program Office, agreed, stating that the Navy real estate contracting officer modified the Marine Corps Air Station Yuma, Arizona, lease on April 28, 2017, to revise the acreage based on the actual acreage being utilized by the Lessee.

Our Response

Comments from the Commander, Naval Facilities Engineering Command, fully addressed the recommendation to modify the lease to reflect the actual acreage being used. Therefore, this recommendation is closed.

[36] 10 U.S.C. § 2667 (2015).

b. Direct the real estate contracting officer to modify the Marine Corps Logistics Base Albany, Georgia, and Naval Air Station Oceana, Virginia, leases to include revised rent schedules developed using the acreage awarded in the leases.

Navy Resilient Energy Program Office Comments

The Commander, Naval Facilities Engineering Command, responding for the Director, Navy Resilient Energy Program Office, agreed, stating that the Navy real estate contracting officer modified the Marine Corps Logistics Base Albany, Georgia, lease on April 14, 2017, to include the revised rent schedule developed using the acreage awarded in the lease. In addition, the Navy real estate contracting officer modified the Naval Air Station Oceana, Virginia, lease on April 26, 2017, to include the revised rent schedule developed based on the acreage shown in the lease.

Our Response

Comments from the Commander, Naval Facilities Engineering Command, fully addressed the recommendation to revise the rent schedules using the correct acreage. Therefore, this recommendation is closed.

c. Develop a process to ensure Navy real estate contracting officers update the lease rent schedule when Navy Resilient Energy Program Office officials adjust the lease acreage.

Navy Resilient Energy Program Office Comments

The Commander, Naval Facilities Engineering Command, responding for the Director, Navy Resilient Energy Program Office, agreed, stating that a process has been developed to ensure Navy real estate contracting officers update the lease rent schedule when Navy Resilient Energy Program Office officials adjust the lease acreage. The Director, Navy Resilient Energy Program Office, or the Acting Deputy, Navy Resilient Energy Program Office, as his designee, shall direct Navy real estate contracting officers to utilize the process. This process was disseminated to the Navy real estate contracting officers responsible for execution and management of Navy REPO Model 2 Leases and is to be utilized as of July 21, 2017.

Our Response

Comments from the Commander, Naval Facilities Engineering Command, fully addressed the recommendation to develop a process to ensure lease rent schedules are updated as needed. Therefore, this recommendation is closed.

Appendix A

Scope and Methodology

We conducted this performance audit from October 2016 through July 2017 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 based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We reviewed solicitations and source selection decision documentation to determine whether the Navy properly awarded the leases. We also reviewed land appraisals, leases, and evaluations of IKC payments to determine whether the Navy obtained fair market value for the leases.

We interviewed personnel from the following offices.

- Office of the Assistant Secretary of the Navy for Energy, Installations, and Environment
- Navy REPO
- Navy and Marine Corps installation public works offices
- NAVFAC Headquarters

We reviewed the following guidance and laws.

- 10 U.S.C. § 2667 (2015)
- 10 U.S.C. § 2924 (2011)
- NAVFAC P-73, "Real Estate Procedural Manual"

Project Selection

As of October 5, 2016, the Navy executed 11 Model 2 leases in support of renewable energy projects. We selected the following 10 leases for review.

- MCB Camp Lejeune, North Carolina
- NSB Kings Bay, Georgia
- MCAS Yuma, Arizona
- NAS Whiting Field OLF Holley, Florida
- NAS Pensacola OLF Saufley, Florida
- NSA Crane, Indiana
- MCLB Albany, Georgia

- NCBC Gulfport, Mississippi
- NSA Mid-South, Tennessee
- NAS Oceana, Virginia

We did not review the lease at West Loch, Hawaii, because a DoD OIG team reviewed it during a prior audit.

Use of Computer-Processed Data

We did not use computer-processed data to perform this audit.

Use of Technical Assistance

During the audit, we received technical assistance from a DoD OIG Technical Assessment Division engineer to determine whether the hardware associated with IKC benefited the Navy.

Prior Coverage

During the last 5 years, the Government Accountability Office (GAO) and the DoD OIG issued two reports on the award of leases supporting energy production projects and the receipt of fair market value for the land. Unrestricted GAO reports can be accessed at http://www/gao.gov. Unrestricted DoD OIG reports can be accessed at http://www.dodig.mil/pubs/index.cfm.

GAO

Report Number GAO-16-487, "DoD Renewable Energy Projects: Improved Guidance Needed for Analyzing and Documenting Costs and Benefits," September 8, 2016

> GAO found that for eight projects, the DoD received little or no financial compensation for the use of its land, and the documentation did not clearly compare the value for granting use of DoD land to the value of what the DoD received for it. As a result, the DoD contributed potentially valuable land for the development of a project without including this as a cost in project documentation.

DoD OIG

Report No. DODIG-2016-137, "The Defense Logistics Agency Properly Awarded Power Purchase Agreements and the Army Obtained Fair Market Value for Leases Supporting Power Purchase Agreements," September 28, 2016

> Defense Logistics Agency Energy contracting officials awarded two power purchase agreements at Fort Hood, Texas, and Fort Detrick, Maryland, using full and open competition, in accordance with Federal and DoD guidance. In addition, the Army obtained fair market value for the two leases supporting the power purchase agreements. As a result, Army personnel ensured that the Army would receive lease payments in the form of in-kind consideration or cash greater than or equal to the fair market value of the leased land.

Appendix B

Comparing Lease Payments to the Fair Market Value of the Land

Because the Navy would receive the IKC in full at the end of the 3-year accrual period, Navy REPO officials used the net present value of total rent due over the lease term as the fair market value for IKC. See Table 2 for the comparison of the fair market value for payment in IKC and the value of the IKC for each lease.

Table 2. ~~(FOUO)~~ Comparison of the Fair Market Value for Payment in In-Kind Consideration and the Value of the In-Kind Consideration

~~(FOUO)~~ Installation	Fair Market Value for Payment in IKC	Value of IKC	Difference
MCB Camp Lejeune, North Carolina	[redacted]	[redacted]	[redacted]
NSB Kings Bay, Georgia	[redacted]	[redacted]	[redacted]
MCAS Yuma, Arizona	[redacted]	[redacted]	[redacted]
NAS Whiting Field OLF Holley, Florida	[redacted]	[redacted]	[redacted]
NAS Pensacola OLF Saufley, Florida	[redacted]	[redacted]	[redacted]
NSA Crane, Indiana	[redacted]	[redacted]	[redacted]
MCLB Albany, Georgia	[redacted]	[redacted]	[redacted]
NCBC Gulfport, Mississippi	[redacted]	[redacted]	[redacted]
NSA Mid-South, Tennessee	[redacted]	[redacted]	[redacted]
NAS Oceana, Virginia	[redacted]	[redacted]	[redacted] ~~(FOUO)~~

Source: DoD OIG.

If the Government does not receive the IKC in full within 3 years, cash payments are due for the 3 years of accrued rent and the remaining term of the lease. See Table 3 for a comparison of the fair market value for payment in cash and the total rent due in the lease rent schedule.

Table 3. ~~(FOUO)~~ Comparison of the Fair Market Value for Payment in Cash and the Total Rent Due in the Lease Rent Schedule

~~(FOUO)~~ Installation	Fair Market Value for Payment in Cash	Total Rent Due in the Lease Rent Schedule	Difference
MCB Camp Lejeune, North Carolina	[redacted]	[redacted]	[redacted]
NSB Kings Bay, Georgia	[redacted]	[redacted]	[redacted]
MCAS Yuma, Arizona	[redacted]	[redacted]	[redacted]
NAS Whiting Field OLF Holley, Florida	[redacted]	[redacted]	[redacted]
NAS Pensacola OLF Saufley, Florida	[redacted]	[redacted]	[redacted]
NSA Crane, Indiana	[redacted]	[redacted]	[redacted]
MCLB Albany, Georgia	[redacted]	[redacted]	[redacted]
NCBC Gulfport, Mississippi	[redacted]	[redacted]	[redacted]
NSA Mid-South, Tennessee	[redacted]	[redacted]	[redacted]
NAS Oceana, Virginia	[redacted]	[redacted]	[redacted] ~~(FOUO)~~

Source: DoD OIG.

Note: Figures in parenthesis represent negative amounts.

Management Comments

Navy Resilient Energy Program Office

DEPARTMENT OF THE NAVY
THE ASSISTANT SECRETARY OF THE NAVY
(ENERGY, INSTALLATIONS AND ENVIRONMENT)
1000 NAVY PENTAGON
WASHINGTON DC 20350-1000

July 26, 2017

MEMORANDUM FOR THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: OFFICIAL MANAGEMENT RESPONSES: NAVY LEASES FOR ENERGY PRODUCTION PROJECTS (Project No. D2017-D000CI-0004.000)

The Department of the Navy comments on the subject draft report are attached. Thank you for the opportunity to review and provide feedback on the subject draft report. My point of contact is [redacted]

Steven Iselin
Acting

Attachments
As stated

Copy to:
NAVINSGEN
NAVFAC

Navy Resilient Energy Program Office (cont'd)

DEPARTMENT OF THE NAVY
NAVAL FACILITIES ENGINEERING COMMAND
1322 PATTERSON AVENUE, SE SUITE 1000
WASHINGTON NAVY YARD DC 20374-5065

5041
Ser 09IG/010
24 Jul 2017

From: Commander, Naval Facilities Engineering Command
To: Department of Defense Inspector General (Attn: Program Director, Contract Management and Payments)
Via: Assistant Secretary of the Navy (Energy, Installations and Environment)

Subj: OFFICIAL MANAGEMENT RESPONSES: NAVY LEASES FOR ENERGY PRODUCTION PROJECTS (Project No. D2017-D000CI-0004.000)

Ref: (a) DoDIG Draft Audit Report 2017-0004 dated 11 Jul 2017

Encl: (1) DON Official Management Responses

1. Per reference (a), enclosure (1) is submitted in response to the subject draft audit report. The NAVFAC Headquarters is providing official management responses to the Draft Report in coordination with the Naval Facilities Engineering and Expeditionary Warfare Center.

2. NAVFAC acknowledges and appreciates the opportunity to continuously improve oversight in the execution and performance of energy production projects and concurs with the recommendations.

4. The NAVFAC Headquarters' point of contact is [redacted] can be reached at [redacted] or via email at [redacted].

[redacted]

ERIK J. KARLSON
Captain, CEC, U.S. Navy
Inspector General

Copy to:
OASN (EI&E)
NAVFAC PW
NAVFAC AQ
NAVFAC OOC
EXWC

Navy Resilient Energy Program Office (cont'd)

Department of Defense Inspector General (DoDIG) Draft Report D2017-D000CI-0004.000 of 11 July 2017:
AUDIT OF NAVY LEASES FOR ENERGY PRODUCTION PROJECTS

The Naval Facilities Engineering Command's (NAVFAC) responses to the findings and recommendations of the DoDIG Draft Report are provided below.

The DoDIG recommends that the Director, Navy Resilient Energy Program Office:

Recommendation 1.a. **Direct the real estate contracting officer to modify the Marine Corps Air Station Yuma lease to include the revised acreage or modify the lease to include a revised rent schedule developed using the acreage awarded in the lease.**

> **NAVFAC Response:** Concur. The Real Estate Contracting Officer Modified the Marine Corps Air Station Yuma Lease on 28 April 2017 with Modification #2, to revise the acreage based on the actual acreage being utilized by the Lessee. This modification was provided to the IG team at the time of execution.
>
> **Target Completion Date:** *Executed Marine Corps Air Station Yuma Lease modification #2 on 28 April 2017, shortly after finding being identified. Action completed.*

Recommendation 1.b. **Direct the real estate contracting officer to modify the Marine Corps Logistics Base Albany, Georgia, and Naval Air Station Oceana, Virginia, leases to include revised rent schedules developed using the acreage awarded in the leases.**

> **NAVFAC Response:** Concur. The Real Estate Contracting Officer Modified the Marine Corps Logistics Base Albany, Georgia Lease on 14 April 2017 with Modification #6, to include the revised rent schedule developed using the acreage awarded in the lease. This modification was provided to the DoD OIG at the time of execution.
>
> The Real Estate Contracting Officer Modified the Naval Air Station Oceana, Virginia Lease on 26 April 2017 with Modification #4, to include the revised rent schedule developed based on the acreage shown on the Lease Attachment A, as amended by Attachment B of Modification #3 to the Lease, dated 7 March 2017. This modification was provided to the DoD OIG at the time of execution.
>
> **Target Completion Date:** *Executed Marine Corps Logistics Base Albany, Georgia Modification #6 on 14 April 2017, shortly after finding being identified; executed Naval Air Station Oceana, Virginia Lease modification #4 on 26 April 2017, shortly after finding being identified. Action completed.*

Page 1 of 2

Enclosure (1)

Navy Resilient Energy Program Office (cont'd)

Recommendation 1.c. Develop a process to ensure Navy real estate contracting officers update the lease rent schedule when Navy Resilient Energy Program Office officials adjust the lease acreage.

NAVFAC Response: Concur. A process has been developed to ensure Navy real estate contracting officers update the lease rent schedule when Navy Resilient Energy Program Office officials adjust the lease acreage. The Director, Navy Resilient Energy Program Office or the Acting Deputy, Navy Resilient Energy Program Office as his designee, shall direct Navy real estate contracting officers to utilize this developed process from this day forward.

Target Completion Date: *This process was disseminated to Navy real estate contracting officers responsible for execution and management of REPO Model 2 Leases via an email, by the Acting Deputy, Navy Resilient Energy Program Office, on 21 July 2017; the e-mail and the related process was provided to the DoD OIG in separate correspondence.*

Enclosure (1)

Acronyms and Abbreviations

IKC	In-Kind Consideration
MCAS	Marine Corps Air Station
MCB	Marine Corps Base
MCLB	Marine Corps Logistics Base
MW	Megawatt
NAS	Naval Air Station
NAVFAC	Naval Facilities Engineering Command
NCBC	Naval Construction Battalion Center
NSA	Naval Support Activity
NSB	Naval Submarine Base
OLF	Outlying Landing Field
REPO	Resilient Energy Program Office
U.S.C	United States Code

Whistleblower Protection
U.S. Department of Defense

The Whistleblower Protection Ombudsman's role is to educate agency employees about prohibitions on retaliation and employees' rights and remedies available for reprisal. The DoD Hotline Director is the designated ombudsman. For more information, please visit the Whistleblower webpage at www.dodig.mil/programs/whistleblower.

For more information about DoD OIG reports or activities, please contact us:

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