



Audit of District Mitigation Banks

Project #06-16

**Prepared by
Office of Inspector General**

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August 8, 2006

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RE: Audit of District
Mitigation Banks –
Report # 06-16

This audit was performed pursuant to the Inspector General's authority set forth in Chapter 20.055, F.S. The objective of our audit was to determine whether District sponsored mitigation banks (Loxahatchee Bank and Corkscrew Bank) create a conflict of interest with privately operated mitigation banks and review existing agreements. This report was prepared by Jankie Bhagudas.

Sincerely,

John W. Williams, Esq.
Inspector General

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BACKGROUND

In accordance with the Office of Inspector General's Fiscal Year 2006 Audit Plan, we conducted an audit of the District Mitigation Banking Program.

The District's Natural Resources Management Division (Natural Resources), organizationally situated under the Environmental Resource Regulation Department in the Water Resource Area, reviews and makes recommendations for approval/denial of Environmental Resource Permits (ERP). Applicants must obtain ERPs before beginning any activity that could affect wetlands, alter surface water flows, or contribute to water pollution. The ERP streamlines the permitting process by combining wetland resources permitting with management and storage of surface waters permitting into a single permit.

Mitigation is the process of restoring, enhancing, creating, or preserving wetlands and/or uplands to offset unavoidable adverse on-site impacts resulting from regulated activities. Natural Resources determines whether the activities proposed in ERPs will cause adverse impacts to wetlands. If wetlands will be impacted, applicants are required to submit mitigation proposals detailing how the impact will be mitigated. Natural Resources evaluate mitigation proposals to ensure that potential impacts have been reduced and/or eliminated to the extent practicable and that any proposed mitigation would offset any adverse impacts. Mitigation success is achieved by providing viable and sustainable ecological and hydrological functions.

Mitigation is best accomplished on-site; however, when this is not possible, off-site mitigation may be an acceptable option if it provides greater improvement in ecological value than on-site mitigation. Mitigation banks are a popular option to satisfy wetland impacts when off-site mitigation is acceptable and permit applicants can purchase the credits from the banks to satisfy their mitigation obligations. (There are other options, e.g., permit applicants can also purchase land off-site and perform the required mitigation.)

Mitigation banks are permitted either by the Department of Environmental Protection Agency (DEP) or a water management district to create, restore, or enhance a

large wetland ecosystem including any associated uplands and awarded credits by the permitting agency for their mitigation efforts. A credit is equivalent to the ecological value gained by the successful creation of one acre of wetland. The number and types of mitigation credits awarded to a bank is based on several factors, for example: the extent to which management activities promote natural ecological conditions, such as fire patterns; the bank's proximity to regionally significant ecological resources or habitats, such as national and state parks; the quality and quantity of wetland or upland restoration, enhancement, preservation, or creation; and the extent that lands to be preserved would be adversely impacted if they were not preserved.

Mitigation banks are assigned a mitigation service area (MSA) by the permitting agency, which is a geographic area within which credits from a mitigation bank may reasonably be expected to offset adverse impacts. Further, within the MSA there may be one or more watersheds, which is the area that currently or historically drains to a waterbody, and in some instance the watershed may be smaller than and are subsets of the MSAs. Watershed impacts are considered before permits are issued.

Based on Section 4.2.8 of the District's Basis of Review, applicants have to provide reasonable assurances that a proposed activity will not result in unacceptable cumulative impact upon wetlands and other surface waters within the watershed of the proposed activity. If an applicant proposes to mitigate wetland impacts using a mitigation bank located within the watershed boundaries of the proposed activity, and the mitigation fully offsets the impact, then the mitigation is not considered to result in a cumulative impact to the watershed and the applicant would not be required to perform a cumulative impact assessment. However, if an applicant proposes to mitigate the impact using a mitigation bank outside the watershed of the impacted site, the applicant is required to perform a cumulative impact analysis to demonstrate that there will be no unacceptable cumulative impacts to the water quality or the functions of wetlands and other surface waters within the watershed that is being impacted. A cumulative impact analysis consider whether impacts of the proposed project, in addition to past, present, and anticipated future projects with similar impacts within the watershed would have an unacceptable negative effect on water quality or other wetlands within the watershed. In other words, it assesses how the watershed would be impacted if similar past, present,

and future impacts were mitigated outside the watershed. If the assessment concludes that the watershed would be unacceptably impacted, then all or part of the mitigation must be done within the watershed.

Chapter 373.4135, Florida Statutes, directed the District to participate in and encourage the establishment of private and public mitigation banks. In addition, the Department of Environmental Protection pursuant to Rule 62-342.850(6), Florida Administrative Code, encouraged each water management district to establish at least two mitigation banks. The District's Land Management Department located in the CERP Resource Area entered into agreements with two private companies to design, permit, and implement two mitigation bank sites on District land. The agreements also required the contractors to obtain required permits, market and sell mitigation credits, and manage, operate, and maintain the sites until the sites can be turned over to the District for long-term land management. Land Management is responsible for administering both contracts.

The District entered into a contract agreement with Foster Wheeler Environmental Corporation (Foster Wheeler) in May 1997 to design, permit, and implement a mitigation site known as the Loxahatchee Mitigation Bank (Loxahatchee Bank). The bank covers 1,264 acres located in Palm Beach County adjacent to the eastern boundary of the Loxahatchee National Wildlife Refuge. The Loxahatchee Bank was permitted by DEP in February 2000 and awarded 647.5 potential mitigation credits within a MSA covering Broward County and portions of Palm Beach County and Martin County. As of December 2005, 299.4 credits have been released for sale and 266.02 credits have either been sold or reserved.

The District also entered into a contract agreement with Mariner Properties Development, Inc., (Mariner Properties) in January 1998 to design, permit, and implement a mitigation site known as the Corkscrew Mitigation Bank (Corkscrew Bank). This bank covers 632 acres and is located in Lee County near the Corkscrew Regional Ecosystem Watershed (CREW). The Corkscrew Bank was permitted by DEP in June 2004 and awarded 351.78 potential mitigation credits with a MSA covering portions of Collier, Lee, and Hendry Counties. As of May 2006, credits have not been released by

DEP to the Corkscrew Bank. Mariner Properties anticipates that credits for the first phase will be released for sale in late 2006.

The use of contractors was envisioned as entrepreneurial mitigation banks where the District would transfer most of the business risks to the contractors since the contractors have to front end all costs, obtain the permits, restore the land, and market and sell the credits. Both contracts provided for the District and the contractors to recoup their costs and share profits generated from the sale of mitigation credits. The District plans to use the revenue generated from the banks to initiate future acquisition, restoration, and management projects. Further, the contracts require that long-term management funds be established using credit sales revenue for the perpetual maintenance of the sites. Upon completion of both contracts, the District will be responsible for the long-term maintenance of both sites.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective focused on determining whether District sponsored mitigation banks create a conflict of interest with privately operated mitigation banks and to review existing agreements.

To accomplish our objective we obtained an understanding of mitigation banking by interviewing key personnel in Natural Resources and reviewing relevant state statutes and other relevant policies and procedures, e.g., the District's Basis of Review for Environmental Resource Permit Applications (Basis of Review), which identifies permit review criteria and information used by District staff when reviewing permit applications. The Basis of Review is based on Chapter 373, Florida Statutes; and Chapters 40E-4, 40E-40, and 40E-400, Florida Administrative Code (FAC). We also interviewed Natural Resources staff to gain an understanding of how applicants go about purchasing mitigation credit to offset unavoidable wetland impacts.

We determined that portions of the MSAs for the Loxahatchee Bank (District's mitigation bank) and the Everglades Mitigation Bank (owned by Florida Power and Light) overlap. Therefore, in instances where it appeared that applicants could have purchased credits from either the Loxahatchee Bank or the Everglades Mitigation Bank, we selected a sample of permits where credits were purchased from the Loxahatchee Bank, during the period October 2004 to March 2006, and reviewed the permit files to determine why mitigation credits were purchased from the Loxahatchee Bank and not from the Everglades Bank. We also interviewed relevant staff to obtain additional information and/or explanations.

We also met with Natural Resources staff at the Lower West Coast Service Center who will be responsible for reviewing ERP applications to determine what measures, if any, are in place to ensure there will be no conflict of interest between the Corkscrew Bank and private mitigation banks.

We also reviewed prior audits performed by our Office regarding District-sponsored mitigation banks and interviewed Land Management staff to determine the status of the banks.

Our audit was conducted in accordance with Generally Accepted Government Auditing Standards.

AUDIT RESULTS

Executive Summary

Our audit disclosed that applicants submit proposals for the mitigation options they intend to use to offset adverse wetland impacts. In instances where the use of mitigation banks are proposed, District staff determines whether the mitigation bank credits proposed by applicants are appropriate as mitigation, considering the type and functions of the wetlands to be impacted and the type and functions of the proposed credits. **If more than one bank offers mitigation credits that are appropriate, the District does not refer or steer applicants to use specific mitigation banks.** Specifically, our review disclosed that in instances where mitigation credits were purchased from the Loxahatchee Bank, applicants chose to use the Loxahatchee Bank and Natural Resources staff evaluated the proposals for compliance with the District's Basis of Review.

According to Natural Resources staff, the Corkscrew Bank will be treated as any other mitigation bank when it starts selling credits. Specifically, applicants will be required to propose mitigation for wetland impacts and all proposals will be analyzed in accordance with the District's Basis of Review. Our review also disclosed that the Corkscrew Bank's watershed is located in an area where development is booming and applicants may opt to use the Corkscrew Bank because cumulative impact assessments will not be required. However, with the District's guidance, the Big Cypress Mitigation Bank is conducting a cumulative impact study of Estero Bay watershed, to partly assist in determining what types of impacts can be mitigated outside the watershed without resulting in an adverse impacts.

It should be emphasized that the two District-sponsored banks were permitted by DEP and, as the permitting agency, DEP is responsible for ensuring that Foster Wheeler and Mariner Properties comply with permit requirements. In addition, the District is not involved in the operation of the banks and the contractors are solely required to ensure compliance with DEP permit requirements. However, Land Management is responsible for ensuring that the contractors comply with the requirements specified in their agreements with the District. Furthermore, Natural

Resources and Land Management are in different resource areas; thus, providing segregation of duties between the permitting and mitigation bank contract monitoring functions. Although we found no conflict of interest in the manner in which the District's mitigation banks are managed there appears to be a perception among private bankers that conflicts exists.

Based on our review of permit files, we concluded that the file documentation could be improved. We noted that in one instance the official permit file did not include a worksheet containing the final assessment scores (mitigation guidelines used to determine the amount of mitigation needed to offset a specific impact); the final scores were in the reviewer's files. In other instance the final assessment scores could not be found in either the permit or reviewer's files. We also noted an instance where the final version of the mitigation credit calculation was overlooked, resulting in an incorrect mitigation credit requirement. Further, in one instance there was no cumulative impact as a result of the proposed offsite mitigation being located in the same watershed, however; the staff report was silent on that issue.

Our review of three prior audits performed by our Office related to the Loxahatchee Bank disclosed that the prior audits questioned Foster Wheeler's practice of imputing interest as a project cost because the contract agreement does not indicate interest costs as an allowable expense. This issue remains unresolved as Foster Wheeler has been unwavering in their position. The amount is now almost \$2 million.

District Staff Do Not Refer Applicants to Specific Mitigation Banks

Our audit disclosed that applicants submit proposals for the mitigation options they intend to use to offset adverse wetland impacts. In instances where the use of mitigation banks are proposed, District staff determines whether the mitigation bank credits proposed by applicants are appropriate as mitigation, considering the type and functions of the wetlands to be impacted and the type and functions of the proposed credits. If more than one bank offers mitigation credits that are appropriate for the specific application, the District does not refer or steer applicants to use specific mitigation banks. Specifically, in instances where mitigation credits were purchased

from the Loxahatchee Bank, applicants chose to use the Loxahatchee Bank and Natural Resources staff evaluated the proposals for compliance with the District's Basis of Review.

In most instances, environmental and/or engineering firms represent property owners. These firms are very familiar with the mitigation banks and the types of credit offered by the banks. In instances where applicants propose off-site mitigation using a mitigation bank, applicants are required to inform the District which bank will be used and the type and number of credits to be purchased.

Review of Mitigation Credits Purchased from the Loxahatchee Bank

The Loxahatchee Bank and the Everglades Bank have overlapping MSAs. Specifically, the Loxahatchee Bank covers Broward County and portions of Palm Beach and Martin County Counties, while the Everglades Bank covers Miami-Dade and Broward Counties and a portion of Palm Beach County. Thus, if certain requirements are met, the Loxahatchee Bank and the Everglades Bank could potentially compete for the same customers (permit applicants) if the impacted site is located in the overlapping MSA. It should be noted that the watersheds for these mitigation banks are smaller than, and are subsets of, the MSAs.

To verify that applicants determined which mitigation bank to use and confirm that Natural Resources staff did not refer applicants to the Loxahatchee Bank over the Everglades Bank, we selected a sample of three permits from a total of 14 permits where adverse wetland impacts were offset via the purchase of credits from the Loxahatchee Bank during the period October 13, 2004 to February 13, 2006. Based solely on the location of the permitted sites, these 14 applicants could have purchased credits from either the Loxahatchee Bank or the Everglades Bank because the sites were in the area of overlapping MSAs.

The following table contains details of the 14 permits and our sample.

Total number of permits issued	14 Permits
Total credits purchased by 14 applicants to satisfy mitigation requirements	63.35 Credits
Total credits purchased by the applicants for the three sampled permits	47.84 Credits
Percentage of credits in sample	75.51%

Our review of the three sampled permit files reaffirmed what Natural Resources staff represented to us. There were no indications in the permit files that Natural Resources staff instructed applicants regarding which mitigation bank to use. Our results are as follows:

- South Florida Area National Cemetery (20.68 credits): The applicant, the Department of Veteran Affairs, indicated in its application that it intended to purchase credits from the Loxahatchee Bank to compensate for proposed wetland impacts. In addition, the Loxahatchee Bank is located in the same watershed as the project, thus, the mitigation will not cause a cumulative impact to the watershed.
- Cleghorn Property (26.05 credits): In its application, Cleghorn Property indicated that it intended to mitigate some of the wetland impact off-site; however, a mitigation plan was not provided. A subsequent request from Natural Resources required Cleghorn Property to provide off-site mitigation plans. There were no suggestions by Natural Resources staff that the credits should be purchased from the Loxahatchee Bank. Cleghorn Property responded that it was negotiating with both the Loxahatchee Bank and the Everglades Bank to purchase credits. In the end, the applicant chose the Loxahatchee Bank.
- Palomino Executive Park (1.11 credits): Initially, the applicant did not include a proposal for mitigating wetlands on-site. After a site visit by Natural Resources staff, it was determined that wetlands would be impacted. Subsequently, Natural Resources requested a mitigation proposal and a letter of credit reservation from a mitigation bank if the impacts were expected to be mitigated off-site using a

mitigation bank. The applicant responded that credits were reserved at the Loxahatchee Bank.

Furthermore, according to the Division Director of Natural Resources Management, she is not aware of any concerns/complaints from the Everglades Bank that District staff members refer applicants to the Loxahatchee Bank.

Applicants May Choose to Use the Corkscrew Bank over Other Mitigation Banks

The Corkscrew Bank was permitted in June 2004 and is expected to compete with several other private mitigation banks once the credits are released in late 2006. A portion of the Corkscrew Bank's MSA overlaps with portions of two other private mitigation banks' MSAs (Big Cypress Mitigation Bank and Panther Island Mitigation Bank¹). In addition, each bank has a different watershed and the watersheds are smaller than the MSAs. Specifically, the MSAs and the watersheds are as follows:

- Corkscrew Bank – MSA covers portions of Collier, Lee, and Hendry Counties; watershed is the Estero Bay watershed.
- Big Cypress Bank – MSA covers portions of Monroe, Collier, Lee, and Hendry Counties; watershed is the East Collier watershed.
- Panther Island Bank – Covers portions of Monroe, Collier, Lee, and Hendry Counties; watershed is the West Collier watershed.

As mentioned in the previous section, if an impacted site is located within the MSA of different banks and certain conditions are met (e.g., the applicant can provide reasonable assurance there will no adverse cumulative impacts to the impacted site's watershed) credits can be purchased from any bank to offset adverse impacts within the watershed. However, applicants may have to incur additional cost to perform cumulative impact assessments if the impacted site is outside the bank's watershed.

According to Natural Resources' staff, development in Lee County is concentrated in the area of the Corkscrew Bank's watershed - the Estero Bay watershed.

¹ As of late March 2006, the Panther Island Bank has only about 100 credits remaining and may be closed by the time the Corkscrew Bank is ready to sell any credits.

Currently, there are no mitigation banks within the Estero Bay watershed other than the Corkscrew Mitigation Bank. Consequently, applicants who cannot offset wetland impacts outside the Estero Bay watershed due to adverse cumulative impacts may have to mitigate on-site or conduct alternative off-site mitigation, such as land acquisition within the Estero Bay watershed. These types of mitigation can be very costly. Thus, when the Corkscrew Bank starts selling credits and off-site mitigation within the Estero Bay Watershed is an option proposed by applicants, and approved by the District, it is most likely that some applicants will opt to purchase mitigation credits from the Corkscrew Bank. According to Natural Resources staff, the Corkscrew Bank will be treated as any other mitigation bank when it starts selling credits. Specifically, applicants will be required to propose mitigation for wetland impacts and all proposals will be analyzed in accordance with the District's Basis of Review

It should be noted that, with the District's guidance, the Big Cypress Mitigation Bank is conducting a cumulative impact study of the Estero Bay watershed to partly determine what types of impacts can be mitigated outside the watershed without resulting in an adverse impacts. This is discussed in greater detail in the following section.

Big Cypress Mitigation Bank Conducting Cumulative Impact Study of Estero Bay Watershed with District's Guidance

As previously mentioned, cumulative impact analyses are required in certain instances if mitigation is proposed outside of an impacted area's watershed. Consequently, if applicants want to purchase credits from the Big Cypress Bank to mitigate impacts in the Estero Bay watershed, applicants may have to demonstrate there will be no cumulative impact to the Estero Bay watershed. The Big Cypress Bank, with the District's guidance, is conducting a study to determine what types, and the percentage of wetland impacts, that can be mitigated outside the Estero Bay watershed without causing an adverse impact. The results are expected to provide information useful to Big Cypress Bank applicants, Panther Island Mitigation Bank applicants, and the District. Specifically, applicants proposing to purchase credits from the Big Cypress Bank or Panther Island Mitigation Bank may not have to incur additional cost for cumulative impact assessments because the study will outline the types and percentages of wetland

impacts that can be mitigated outside the Estero Bay watershed. In addition, the Natural Resources staff may be able to refer to the study to determine whether proposed mitigation will result in adverse cumulative impacts.

District will Continue to Require Applicants to Propose Mitigation

We spoke with the Natural Resources' staff at the Lower West Coast Service Center to determine what additional measures, if any, would be instituted to ensure there will be no appearance of any conflicts of interest between the Corkscrew Bank and the Big Cypress and Panther Island Mitigation Banks. Staff's responses were the same as those noted during our review of the Loxahatchee Bank (i.e., applicants are responsible for proposing how wetland impacts will be mitigated and in instances where mitigation banks are proposed, applicants are required to propose the bank they wish to use). According to a Senior Supervising Environmental Analyst at the Lower West Coast Service Center, all proposals are evaluated in accordance with the District's Basis of Review and this practice will continue when the Corkscrew Bank starts to sell credits. Further, cumulative impact assessment results are required in all ERP Staff Reports.

Permit Documentation Could be Improved

Based on our review of the three permit files in our sample, we concluded that the documentation could be improved. For example, some files were missing documentation and, in one case, off-site mitigation credits were calculated incorrectly. Specifically, we noted the following:

- *South Florida Area National Cemetery Permit Files*: The official permit file did not contain either the final functional assessment scores (WRAP scores), which were used to determine the number of credits required for off-site mitigation, or calculations showing how the number of credits was determined. Upon our request, the Natural Resources permit reviewer provided these documents as they were in his office files. In addition, we noted that the Staff Report did not contain any specific reference to a cumulative impact assessment. In this instance, an assessment was not required because mitigation was within the watershed. We

believe a statement explaining why cumulative impact assessments are not required could enhance the reports.

- Cleghorn Property Permit Files: The permit files did not contain the final functional assessment scores (WRAP scores), which were used to determine the number of credits required for off-site mitigation. In addition, based on a worksheet contained in the file, 26.05 credits were required to mitigate the impacted wetlands. However, we verified the calculations on the worksheet and determined that 26.21 credits were required. Although the difference is only .16 credit, every effort should be made to ensure that credit calculations are as accurate as possible in order to provide greater assurance of mitigation success. It should be noted that there were instances where as little as .02 credit was required to off-set wetland impacts.

Unresolved Issues from Prior District Audits of the Loxahatchee Mitigation Bank

Three prior audits² performed by our Office related to the Loxahatchee Bank questioned Foster Wheeler's practice of imputing interest as a project cost. The contract agreement does not specify interest costs as an allowable expense. Based on the contract agreement, Foster Wheeler is entitled to recover reasonable design, development, permitting, and administrative start-up and certain other costs. Further, the interest expenses were not directly traceable to any actual bank charges but rather were imputed based rates set by Foster Wheeler and applied to the cumulative cost of the project. Foster Wheeler has been unwavering in their position, thus, this issue has not been resolved. The interest expense is now almost \$2 million and will continue to increase.

² The three audits were as follows: *Interim Audit of the Loxahatchee Mitigation Bank Contract*, Report #99-16; *Audit of the Mitigation Banking Program*, Report #99-18; and *Audit of Claimed Interest Costs – Foster Wheeler Environmental Corporation – Contract No. C-8301*, Report #01-07

Recommendations

1. **Ensure that the final functional assessment scores are maintained in the permit files since these scores are used to determine mitigation credit requirements and the files are public record.**

Management Response: Management concurs and Natural Resource Management Division (NRM) staff will receive additional direction regarding the proper disposition of file documentation for all type of permits (not just those utilizing the Loxahatchee Mitigation Bank) once an application is complete. A meeting of all NRM staff is scheduled for August 23, 2006. The results and recommendations of the audit will be discussed at the meeting.

Responsible Department: Environmental Resource Regulation Department

Estimated Completion Date: August 23, 2006, then ongoing as permits are issued

2. **Instruct Natural Resources staff to verify all credit calculations submitted by applicants in order to ensure that impacts to wetlands are appropriately mitigated.**

Management Response: Management concurs and Natural Resource Management Division staff will receive additional training on this topic. District staff actually conducts a separate UMAM calculation from the consultant, but may rely on information submitted by the consultant and incorporate that information into the District's calculation. A meeting of all NRM staff is scheduled for August 23, 2006. The results and recommendations of the audit will be discussed at the meeting.

Responsible Department: Environmental Resource Regulation Department

Estimated Completion Date: August 23, 2006 and ongoing as permits are issued

- 3. Require that all staff reports that have wetland impacts and a mitigation component include a cumulative impact assessment statement.**

Management Response: Management concurs. Natural Resource Management Division staff will be directed to include a cumulative impact assessment statement in all staff reports involving wetlands and mitigation. In addition, the automated staff report database from which staff reports are generated will be modified to include standard language that addresses the cumulative impact issue. The reviewer will then be able to modify that language for the specific project.

Responsible Department: Environmental Resource Regulation Department

Estimated Completion Date: August 23, 2006 and ongoing as permits are issued

- 4. Consult with the Office of Counsel regarding options available for resolving the imputed interest expense issue with Foster Wheeler.**

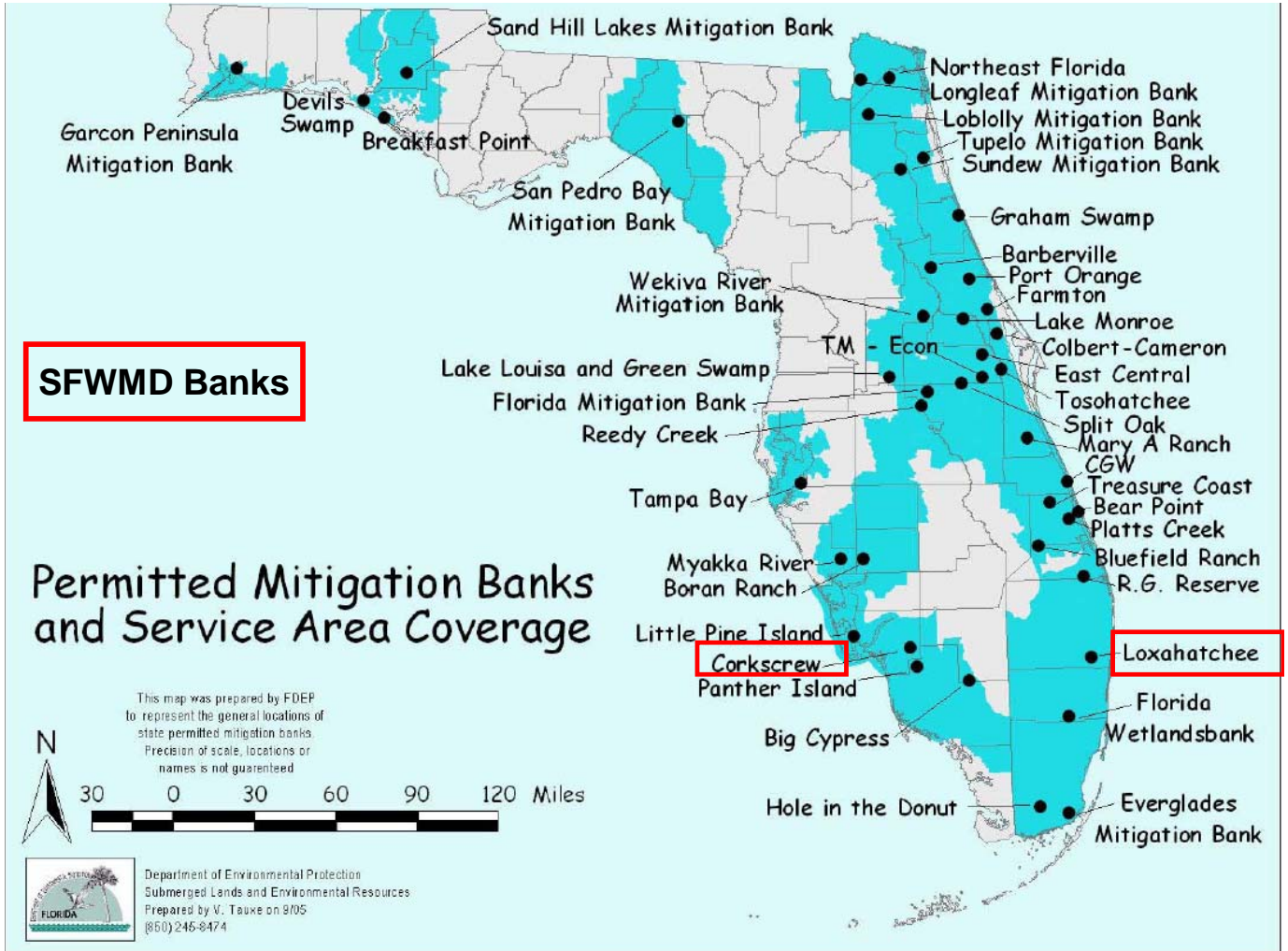
Management Response: Management concurs and recognizes that after several years of working to resolve this outstanding issue that Foster Wheeler (now known as TetraTech ECI) and the District have not attained agreement because both sides have been firm in their positions. Since the Loxahatchee Mitigation Bank has not yet become profitable, the District has not lost anything as a result of the TetraTech practice of charging interest as a project cost. However, the project is expected to become profitable in calendar year 2007 so resolution of this issue is critical. As recommended by the audit, Land Resources will coordinate with the Office of Counsel to develop a list of options available for resolving the interest issue with TetraTech.

Responsible Department: Land Management & Operations

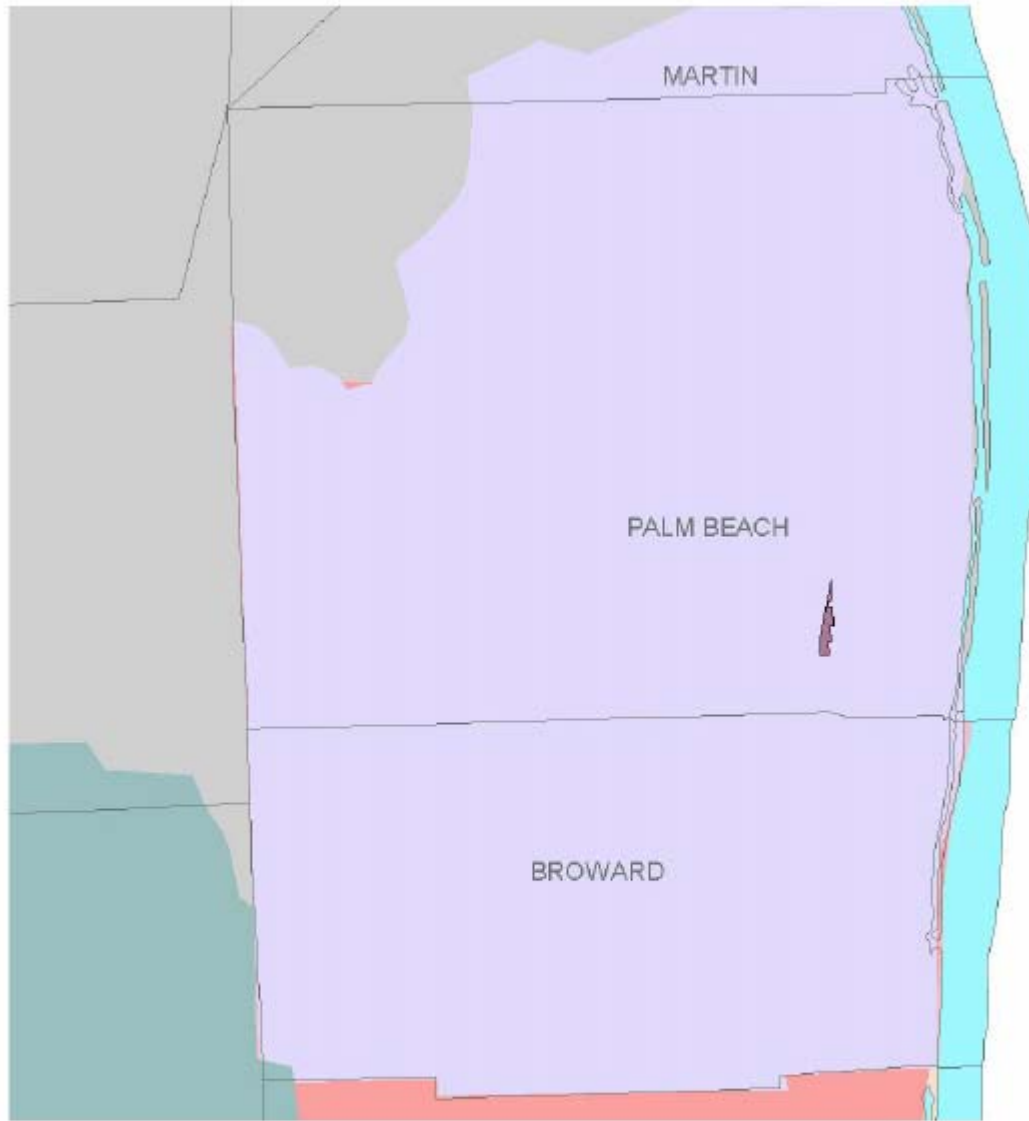
Estimated Completion Date: September 2006

APPENDICES

Map of Florida Permitted Mitigation Banks

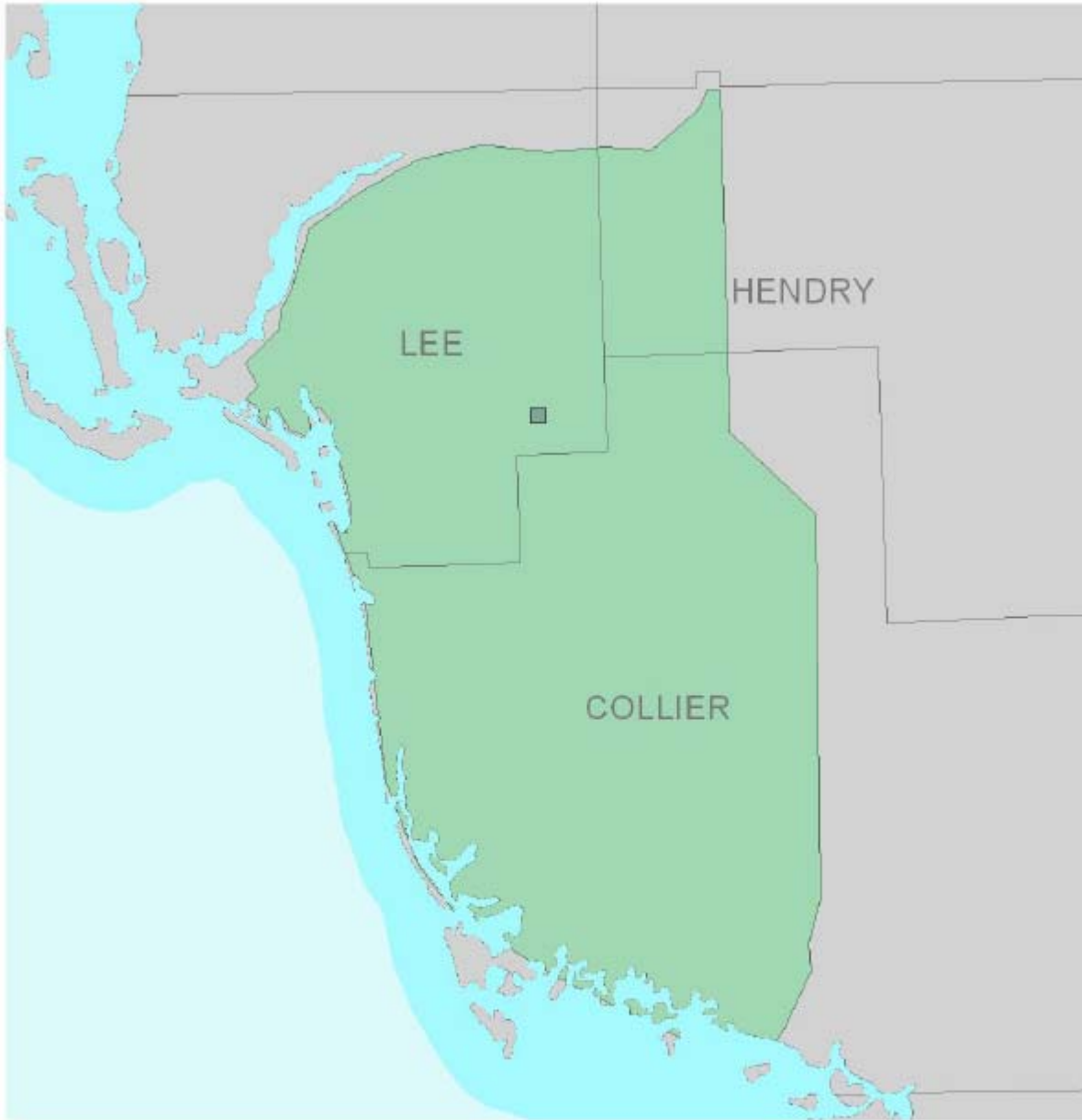


Loxahatchee Mitigation Bank



**Loxahatchee Mitigation Bank (in Palm Beach Co.)
and Mitigation Service Area (violet)**

Corkscrew Regional Mitigation Bank



Corkscrew Regional Mitigation Bank (Lee Co.)
and Mitigation Service Area (green)