



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

State Capitol
Nashville, Tennessee 37243-9034
(615) 741-2501

Justin P. Wilson
Comptroller

June 25, 2013

The Honorable John G. Morgan, Chancellor
Tennessee Board of Regents
1415 Murfreesboro Road, Suite 340
Nashville, Tennessee 37217
and
Dr. Anthony Wise, President
Pellissippi State Community College
P. O. Box 22990
Knoxville, Tennessee 37933-0990

Gentlemen:

Transmitted herewith is the review of issues surrounding the state's purchase of the property at 7201 Strawberry Plains Pike in Knox County that is currently being used as Pellissippi State Community College's east campus. The broad allegations our office received painted the acquisition of this property as one that was unnecessary, not properly vetted, and possibly even politically motivated.

Our review determined that the facility, although more spacious than was needed in the short-term, appeared to be a reasonable site for a new campus as it provided for immediate occupancy for basic instruction classes, the office spaces could be converted to classrooms at costs lower than new construction, and the proximity to the interstate made it reasonably accessible for residents in the areas targeted by the college. Our review determined that the price of the property was negotiated and the acquisition price appeared reasonable. We determined that notwithstanding the lack of a written agreement with the sellers for minor repairs and lack of an approval on a Pellissippi State Community College (PSCC) lease, the procedures were properly followed by those state employees who requested the acquisition and those state employees overseeing the acquisition process. Moreover, we did not uncover any evidence of undue influence by the Governor or the Governor's Office regarding the acquisition.

Our review did note the following areas which deserve attention:

- Presentations to the SBC or the SBC executive subcommittee should be developed by TBR staff with the most accurate and timely information possible. The accuracy of information should be verified by officials from the respective college prior to its presentation.
- College officials should ensure that they adhere to applicable TBR policies regarding future leases.
- Future agreements such as the verbal agreement with the sellers of the Strawberry Plains property need to be formally recorded as recommended by TBR guidelines.

In closing, prompt and prudent attention to these areas should improve the acquisition process.

Sincerely,



Justin P. Wilson
Comptroller

JPW/ct

Cc The Honorable Bill Haslam, Governor
The Honorable Steven G. Cates, Commissioner, Department of General Services



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765**

June 24, 2013

The Honorable Justin P. Wilson,
Comptroller of the Treasury

Dear Mr. Wilson:

At your request, our office has reviewed the issues surrounding the state's purchase of the property at 7201 Strawberry Plains Pike in Knox County for the use of Pellissippi State Community College's east campus. The issues originated from a newspaper article and hotline call to this office alleging that politically connected businessmen sold a vacant building to the state for \$10 million, which was twice what they paid for it, and that the building was in need of significant repairs. It was also alleged that the current administration made this transaction a priority as a favor to the sellers, Furrow Realty Fund L.P. Although no specific benefits to the state officials were stated in the allegations, the broad statements about the acquisition painted it as one that was unnecessary, not properly vetted, and possibly even politically motivated.

Our review consisted of:

- inquiries of state employees involved in the Strawberry Plains property acquisition,
- walk-throughs of the processes required for acquisitions,
- interview of the managing general partner for the sellers,
- analysis of the documents obtained through our inquiries, research, and walk-throughs, and
- review of e-mails and other correspondence relating to the Strawberry Plains property acquisition.

Our review determined that the facility, although more spacious than was needed in the short-term, appeared to be a reasonable site for a new campus as it provided for immediate occupancy for basic instruction classes, the office spaces could be converted to classrooms at

costs lower than new construction, and the proximity to the interstate made it reasonably accessible for residents in the areas targeted by the college. Our review determined that the price of the property was negotiated and the acquisition price appeared reasonable. We determined that notwithstanding the lack of a written agreement with the sellers for minor repairs and lack of an approval on a Pellissippi State Community College (PSCC) lease, the procedures were properly followed by those state employees who requested the acquisition and those state employees overseeing the acquisition process. Moreover, we did not uncover any evidence of undue influence by the Governor or the Governor's Office regarding the acquisition.

Background

The building and land acquired on March 9, 2012, by the State of Tennessee on behalf of the college for an additional campus site is located off Interstate 40 at Strawberry Plains Pike, exit #398. The campus site is east-northeast of downtown Knoxville, in the far eastern portion of Knox County. According to an environmental assessment of the property in 2005, the former Philips Consumer Electronics building was built in 1982 and included approximately 220,000 total square feet of space that was originally used for marketing, administration, and engineering personnel. The structures include a three-level office building with approximately 175,000 square feet, a 9,000-square-foot cafeteria, an 8,200-square-foot design center/theatre-style presentation room, a warehouse of approximately 27,000 square feet, and two smaller buildings. The Strawberry Plains property includes approximately 32 acres of land. In 2006, the property was vacated by Philips Electronics and subsequently purchased by Furrow Realty Fund L.P. on July 27, 2007, for \$5 million.

Strawberry Plains Property a Reasonable Site for New Campus

Our review determined that the Strawberry Plains facility, although more spacious than was needed in the short term, and located outside of the college's expansion plans, appeared to be a reasonable site for a new campus. As documented in the college's 2007 master plan, a new campus was envisioned in northern Knox County, Tennessee, by college officials as the college was expected to reach maximum capacity at all four existing campuses. The master plan showed a new campus on a 30-acre property with an expected need of only 57,000 total square feet of building space after the first three years. Our review determined that the former president of Pellissippi State Community College took an interest in the Strawberry Plains property in 2009 after failing to find a building suitable for a campus in northern Knox County. Although the former president stated he did not recall how he first became aware of the property, he stated that after the Tennessee General Assembly appropriated special capital outlay funds of \$120 million to further the capacity of the community college system in April 2010, he contacted the general partner of Furrow Realty Fund L.P. to discuss the property. In July 2010, the college had an initial appraisal of the Strawberry Plains property performed, and its value was assessed at

\$10,850,000 (appraisal 1). On September 16, 2010, PSCC entered into a six month lease of the Strawberry Plains property to secure the building for possible acquisition.

The former PSCC president had a feasibility study prepared in October 2010 which showed that most of the higher education participation rates of those residents age 18 and over living in eastern/northern and southern Knox County were below the rates of residents living in western Knox County. The Strawberry Plains property's close proximity to the interstate made it reasonably accessible for residents in the three areas targeted by the college.

After the acquisition was approved by the State Building Commission in January 2011, the former PSCC president entered into another six-month lease of the property. Additionally, the state had two appraisals performed before it entered into an option to purchase agreement in July 2011. An attachment to the option to purchase agreement required that the sellers address and correct the listed items pertaining to the property prior to closing.

In December 2011, college officials developed an expansion plan for the East Knox campus, which included initial occupancy of 30,000 and occupancy of approximately 90,000 square feet after three years. The expansion plan also included proposed renovations each year to provide for expanded college occupancy, a higher education center, and space that could provide rental income. The architects hired to evaluate the proposed east campus project estimated the cost of upgrades to codes, building and service deficiencies, and the subdivision of existing space of the entire 220,000 square feet for availability for the college to be \$16.6 million.

The closing on the property was delayed primarily because the sellers had not completed the corrective measures as required in the option to purchase agreement. Once those repairs were completed, the closing on the property took place on March 9, 2012.

Our review determined that the building required minimal repairs before students began attending basic classes in August 2012. During the period from closing to August 2012, the college incurred construction costs of \$36,061 and \$73,431 in building and equipment maintenance costs to provide the initial 30,000 square feet of space for classrooms and administrative offices.

Tennessee Board of Regents (TBR) officials have contracted for the renovation of approximately 60,000 square feet of additional space to be occupied by the college for \$1,340,000. A large portion of the estimated renovations to the facility will be performed by the renter of approximately 85,000 square feet of building space as stated in a recently signed lease agreement. In December 2012, the Tennessee Department of General Services entered into a five-year lease and agreed to perform all tenant improvements within the leased area at its expense in lieu of a monthly rental fee.

Additional repairs on the Strawberry Plains campus will be funded through state appropriations for capital projects through the fiscal year ending June 30, 2013, which included \$600,000 for roof replacement, \$2.2 million for HVAC replacement, and \$300,000 for repaving the parking lot and wheel chair entries.

The Strawberry Plains' acquisition price plus the total planned or actual repairs and renovations equates to \$14,549,493, and will supply the college with approximately 90,000 square feet of space at a cost of \$162 per square foot. This price per square foot is considerably lower than Pellissippi State Community College's relatively new Blount County campus, which provides for approximately 71,300 square feet of building space at a cost of approximately \$21.5 million, or \$300 per square foot.

Price of Strawberry Plains Property Was Negotiated and Appeared Reasonable

Our review determined that the price of the Strawberry Plains property was negotiated and the acquisition price appeared reasonable. According to the former president and the general partner for the sellers, the original asking price was approximately \$12 million and included an easement to the billboard on the property and the office furniture that remained in the building. The former president also stated that he and the general partner discussed an \$8 million price tag, but that deal left the sellers with ownership of the front section of land bordering Strawberry Plains and was not an acceptable arrangement for the college. In the end of negotiations, a selling price of \$10 million was agreed upon.

Our review confirmed that the vacant building purchased by the state for \$10 million had been purchased five years earlier by the current seller, a real estate investment group, for \$5 million. It appears the investment group was able to acquire the property for significantly less than the asking price of \$10.3 million as stated in a July 2007 article about the former Philips Electronics (Magnavox) North American headquarters facility.

After the acquisition was approved by the State Building Commission in January 2011, the state contracted to have two subsequent independent appraisals performed in early 2011. These appraisals estimated the property value to be between \$11.2 million (appraisal 2) and \$11.6 million (appraisal 3).

One issue raised about the price of the property was that it had been assessed for tax purposes at less than \$4.4 million, which was far below the state's purchase price. This assessment was confirmed with the Chief Deputy Assessor for Knox County with additional input in that the 2009 tax assessment was performed by a former property tax assessor and the method of the assessment was questionable and should not be considered market value.

Notwithstanding the 2009 tax assessment, our review determined that the selling price for the property appeared reasonable with three independent appraisals all placing the value of the property over \$10 million. All three appraisals used both an income and a comparative sales/market value approach and were prepared by Tennessee certified appraisers with active licenses. It should be noted that because of the size of the multi-levels of office space facility on Strawberry Plains Pike, the appraisers apparently could not find similar sized facilities and acreage as many of the comparisons included smaller facilities and acreage. Furthermore, some of the property sales used in comparisons were several years old. Even without comparable or current property sales, the three independent appraisals were within \$750,000 or less of one another.

Acquisition Procedures Were Properly Followed by State Officials

We determined that procedures were properly followed by those state employees who requested the acquisition and those state employees overseeing the acquisition process.

Our review determined that the plans for the Strawberry Plains acquisition and renovations were presented before the State Building Commission (SBC) as required by state law. Section 4-15-102 (d) (1) (A), *Tennessee Code Annotated*, requires the approval by the SBC for the acquisition of any interest in real property by the State of Tennessee or any of its departments, institutions, or agencies. Land acquisitions and lease transactions have been delegated to the SBC's executive subcommittee, which consists of the three constitutional officers and the Commissioner of the Department of Finance and Administration.

The proposed \$10 million project including the acquisition and renovations was presented and approved by the SBC on January 24, 2011. The proposed project from the Tennessee Board of Regents included the required documents: the RPM-1 (application), tax maps, the owner's general information, funding sources, and photos of the property. The RPM-1 form was properly submitted to the Department of Finance and Administration's Division of Real Property Management, which is currently referred to as State Real Estate Asset Management (STREAM) within the Department of General Services. STREAM personnel are responsible for the general oversight of state projects. The sources of funds listed on the RPM-1 included \$8.5 million from the special capital outlay and a required matching private funding of 15 percent of the \$10,000,000 project (\$1.5 million) which was to be funded through the college's foundation. Statements on the form also provided the information that the property was part of the 2007 campus master plan envisioned for northern Knox County.

Our review determined that there were some discrepancies between the communications to the State Building Commission's executive subcommittee regarding the Strawberry Plains acquisition, but those discrepancies were subsequently remedied or not material overall. In the January 24, 2011, presentation to the executive subcommittee, the following statements from

TBR's Executive Director of Facilities Development (statements 1 and 2 below) and STREAM's Director (statement 3 below) were not factual:

1. A statement was made in the presentation that the estimated acquisition price was \$8 million, based on the sellers' offer to the college. Although the \$8 million offering price was presented as an estimate, it was known or should have been known that the offering price was \$10 million at the time of the presentation. Prior to the presentation to the executive subcommittee, PSCC Vice President for Business and Finance sent an e-mail communication to TBR staff regarding \$10 million for total project costs, which should have been \$12 million, composed of a \$10 million acquisition price and \$2 million for renovations. In the preparation of forms to be presented before the State Building Commission, TBR personnel set the acquisition estimate at \$8 million; based on communications from the college that the total project was \$10 million and included \$2 million for renovations. This misinformation was corrected through a revised project proposal prior to the closing on the property. In September 2011, a \$2 million adjustment was proposed and approved by the SBC, making the total project \$12 million. The state funds provided from the special outlay remained at \$8.5 million. Another \$2 million in the college's existing state appropriations was added through the college's budget for campus plant funds, \$1.1 million was derived from contributions from the PSCC foundation, and Furrow Realty Fund L.P. contributed \$400,000. The misinformation resulted in the required matching private funds to be understated by \$300,000 (\$12,000,000 total project times the required 15 percent match equates to \$1,800,000 rather than the \$1,500,000 contributed).
2. A statement was made in the presentation that the proposed new campus project for eastern Knox County was included in the 2007 campus master plan. The new campus project was actually proposed for an unspecified location in northern Knox County. The master plan did not include a proposed new campus for eastern Knox County. The proposed new campus for northern Knox County was disclosed on the form presented to STREAM personnel.
3. A statement was made in the presentation that a billboard easement on the property would be included in the acquisition. The billboard easement, however, was retained by the sellers. Rather than acquire the billboard, college officials' concerns over advertisements on the billboard were addressed through an amendment to the easement at closing.

Our review determined that procedures were properly followed by the STREAM personnel overseeing the project. Once approved by the SBC, STREAM personnel properly ordered the title survey, property survey, appraisal of the property, architectural evaluation, and environmental study through state contracts. These contracted services were ordered over the

period from the SBC executive subcommittee's approval on January 24, 2011, through October 4, 2011, when the property survey was ordered. On November 11, STREAM personnel received the completed property survey, and by December 12, 2011, STREAM personnel had finished reviewing and approving the appraisals of the property.

Delay in Closing on Strawberry Plains Property Due to Repair and Mold Issues

Although the state's acquisition procedures had been completed except for closing items including but not limited to the title policy, deed form, and easement amendment, the closing on the Strawberry Plains property was delayed because the 13 listed repair items and operational tests required from the seller, according to the option to purchase agreement, had not been completed. One of the more critical items on the listing was the presence of mold on the first floor of the facility. TBR officials stated that they delayed the closing on the property until the list of items, including the mold remediation, had been completed.

The closing on the property did not occur until March 9, 2012, after the mold remediation report was issued on February 26, 2012, by the environmental consultants stating that there were no more signs of mold spores inside the building. Additionally, the project architects reported to TBR officials that all listed repairs had been completed. Additional letters from engineers and contractors confirmed that mechanical, plumbing, and emergency systems of the facility were operational before the closing.

Minor Repairs Not Addressed

College officials failed to document or secure compensation for minor repairs required of the sellers at closing or afterward, which deviated from TBR general guidelines. In the process of completing those listed repairs above, several areas of the Strawberry Plains facility were affected and required minor repairs. The PSCC President stated there was carpeting and tiling that was not performed by the sellers before the closing on the property on March 9, 2012, and he estimated the total costs to be \$40,000. The PSCC President stated that he had purposely not settled with the sellers on the minor repairs in hopes that the college could trade the repairs for the easement on the billboard that the sellers retained. TBR officials and STREAM officials were informed of the minor repairs and told that PSCC officials would resolve the repair issue with the sellers directly. On May 1, 2013, Furrow Realty Fund, L.P. issued a check to PSCC for \$41,830 to cover the costs associated with the minor repairs.

The failure to document the agreement deviates from TBR guideline No. G-030, which requires agreements to be complete and documented in writing. According to the guideline, no relevant terms should be left to an unwritten "understanding" or verbal agreement; no oral representation of any official agent, or employee of either party, either before or after the

execution of an agreement, is binding on the parties. The document should be explicit and clearly state the rights and duties of each party and clearly identify all parties.

No Undue Influence or Improper Benefits to State Officials

In the course of this review, we did not uncover any undue influence by the Governor or the Governor's Office. As pointed out in the newspaper article, a November 2011 inquiry was made on behalf of the sellers via e-mail to the Governor's Chief of Staff, as to whether everything but the final approval on the sale was in place. The e-mail requested that the closing occur before the year end. This e-mail was forwarded to the TBR Chancellor and eventually to the Commissioner of General Services. The Commissioner asked STREAM staff about the status of the project. STREAM staff responded that TBR did not want to close on the property until all items on the repair list were completed by the sellers. The Commissioner then forwarded his staff's response to the Governor's Chief of Staff.

Two weeks later, the Governor's Chief of Staff sent the phone number of the managing general partner for the sellers to the Commissioner of General Services. According to the Commissioner, he called the managing general partner and they discussed the delay in closing. The Commissioner stated that the state's position was that the sale was not going to close until after the repairs agreed upon in the option to purchase were completed.

Our review did not find that the Commissioner's inquiry into the status of the project nor his conversation with the managing general partner for the sellers prompted STREAM officials to take additional actions outside of normal procedures.

The Commissioner of General Services toured the Strawberry Plains property several months after his conversation with the managing general partner for the sellers. The Commissioner stated he was in Knoxville to view other state property in need of a replacement and wanted to view the Strawberry Plains facility as a possible site for new offices for state workers.

Our review included the identification of individuals in the seller's limited partnership and matching those individuals against a current state employee listing. According to a partnership resolution of Furrow Realty Fund L.P. authorizing the sale of the Strawberry Plains property to the state, the limited partnership included six individuals and two additional limited partnerships. From our review of these partnerships, none of the partners were listed as current state officials, nor were any business ventures revealed during this review that involved the partners and current state officials.

Lease of Property

One additional item was noted during our review that did not directly relate to the reasonableness of the Strawberry Plains acquisition or to acquisition procedures. The college's lease of the Strawberry Plains property prior to acquisition was not properly approved by TBR as required by policy. PSCC officials entered into back-to-back six-month leases of the Strawberry Plains property from September 16, 2010, through September 10, 2011, with a \$1,400-a-month lease payment plus \$1,000 each month for utilities. The purpose of the lease was to secure the building for possible acquisition and to allow PSCC officials to hold fund raising events. PSCC's expenditures under the lease agreements for the fiscal year ending June 30, 2011, totaled \$22,800 and were only approved by college officials. The leases were required to be approved by the TBR Chancellor as required by TBR Policy No. 1:03:02:10, which states, "All agreements involving or related to the lease of real property for a term of more than five (5) years or a consideration of more than \$15,000 per year shall be approved by the Chancellor."

Sincerely,



Deborah V. Loveless, CPA
Director