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Audit Report

**CHARLES CHRIN
REAL ESTATE TRUST
MEMORANDUM OF
UNDERSTANDING**

As of October 2016

**Office of the Controller
County of Northampton
Pennsylvania**



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May 23, 2017

Members of the Northampton County Council
John A. Brown, County Executive
County of Northampton, Pennsylvania

We have completed an audit of the Charles Chrin Real Estate Trust Memorandum of Understanding as of October 31, 2016.

The Executive Summary on page one summarizes the audit results, while the Audit Results section provides a detailed explanation.

We acknowledge the cooperation and assistance we received from Fiscal Affairs, the Recorder of Deeds, the County Solicitor and the Chrin organization's attorney. Their help was essential to the performance of this audit.

Management's response is included in the Audit Results section of the report.

Very truly yours,

Stephen J. Barron, Jr., CFE
County Controller

Gary M Krall, CMA
Auditor

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INTRODUCTION

In 2010, the County and Chrin reached a verbal agreement that was later recorded and signed by both parties in October 2011. This agreement with Chrin became the Memorandum of Understanding (MOU). It pertains to land near the intersection of Route 33, Tatamy Road and Van Buren Road in Palmer Township that Chrin owns and was made part of a Tax Increment Financing (TIF) financing subsidy.

In 2011, the County approved the TIF for 691 acres of land that Chrin owned in this area. Specifically, Chrin is to receive a portion of future real estate taxes on the property covered by the TIF for the next 30 years in exchange for the Chrin companies financing a portion of the interchange and ancillary infrastructure that opened in July 2015.

The MOU initially included 17 parcels of land within the TIF area covering approximately 690 acres. Three parcels were combined with a fourth parcel resulting in a pool of 14 parcels. Five of these parcels are located partly in Palmer Township and partly in Upper Nazareth. The remaining parcels are exclusively in Palmer Township. Only those areas of such parcels within Palmer Township are included in the TIF and thus only the portions of those properties within the Route 33 TIF are qualified property for purposes of the MOU.

The County is to receive one and one-half percent (1.5%) of the net selling price of any qualified property within the TIF district. Those funds are to be used exclusively by the County for farmland preservation. Net selling price means the gross sales price for any qualified property minus any and all closing costs incurred in connection with the sale of the qualified property. The payments are seen as necessary to preserve farmland in return for the construction of the interchange and the loss of valuable farmland in the region. The payments are called "Farmland Preservation Contributions" and the total of these contributions are capped at \$2,000,000. The County agreed that all Farmland Preservation Contributions will be used exclusively for farmland preservation. Through the end of October 2016, the total amount of Farmland Preservation Contributions was \$204,463, realized from the sale of four parcels. One parcel sale had a zero net selling price and did not generate a contribution. Maria Bentzoni, Farmland Preservation Administrator, expects that these funds won't be used for easement purchases until mid to late 2017.

Two warehouse/distribution facilities were built on two of the parcels and a third is currently under construction. The first parcel sold at 1560 Van Buren Rd. has a 426,000 sq. ft. warehouse/distribution facility and opened in 2015; it is part of the DCT Chrin Commerce Center. The second parcel sold, now known as 1610 Van Buren Rd., was purchased and developed by Duke Realty and contains the 1.1million sq. ft. Amazon fulfilment center which opened in 2016. Duke Realty recently broke ground on *prospective building 2* on the third parcel sold in the TIF

at 1611 Van Buren Rd. The 628,475-square-foot industrial building is scheduled to be completed in mid-2017. Duke Realty also owns the parcel now known as 1620 Van Buren Rd. that is being marketed for a potential 1.0MM sq. ft. warehouse and distribution facility.

EXECUTIVE SUMMARY

We reviewed and examined the records and documentation for the four parcels of land sold by the Charles Chrin Real Estate Trust (Chrin) to date and found that the County and Chrin met the covenants and conditions as provided in the Memorandum of Understanding dated October 20, 2011. The payments to the County for Farmland Preservation Contributions were made timely, and were recorded promptly and accurately by the County in the financial records.

The selling price for all of the properties matched the figures recorded in the records of the County's Recorder of Deeds. We were unable to definitively assess whether or not the selling price reflected fair market value as many conditions and variables factor into determining the selling price for each parcel.

The largest component of closing costs in each parcel sale was the mortgage repayment cost. We were not given permission to access the Chrin Companies' bank records or to contact their bank directly to independently verify the individual amount of each mortgage repayment listed on the settlement sheets. Consequently, the net selling price for each individual parcel sold could not be validated. However, after examining the "Release of Mortgage" records on file with the Recorder of Deeds, we were able to reasonably conclude that the aggregate mortgage costs listed on these documents is very close to the combined amounts of mortgage debt retirement listed on the settlement sheets.

The Farmland Preservation Contributions as of 10/31/16 totaled approximately \$204,460. The funds are in a money market account which has earned \$265 in interest through 10/31/16.

PURPOSE AND SCOPE

On October 20, 2016, County Council adopted Resolution 102-2016 requesting that the Controller's Office "perform an audit with regard to the Memorandum of Understanding containing covenants running with real estate between the County of Northampton and the Charles Chrin Real Estate Trust." Our overall audit objectives were to:

- Determine if the County of Northampton has met the promises, covenants, and conditions as provided for in the MOU.
 - Determine if Chrin has met the promises, covenants, and conditions as provided for in the MOU including but not limited to:
 - ◆ That the payments to the County were made in a timely manner based on the transaction dates involving "Qualified Properties."
 - ◆ That the "Net Sales Price" transactions payments are accurate and reflect fair market value.
 - ◆ That the "Closing Cost" transactions are accurate, reasonable, and reflect the marketplace for services provided.
-

METHODOLOGY

Our methodology included:

- Interviewing the administrator in Fiscal Affairs responsible for the accounting and administrative work for the Chrin TIF and MOU, the County's solicitor involved in reviewing the MOU, the attorney for the Chrin organization, the Farmland Preservation Administrator and the Recorder of Deeds.
- Reviewing and studying the content of the MOU, the sales settlement sheets, County assessment and property tax records, background information about the project (Chrin Commerce Center) and discussing the program with people directly involved with the program. We also reviewed the business relationship between the Chrin companies and the development companies active in the TIF zone.
- Careful review of the sales settlement sheets to substantiate the selling price and closing costs, and crosschecking them with County records. We also validated the Farmland Preservation Contribution for each property, and verified the receipt and recording of the contribution in the County's financial records.
- Reviewing the individual transactions for compliance with terms outlined in the MOU up to, and including, the planned use of the contribution by the

Farmland Preservation Administrator.

Our review included an assessment of internal controls in the audited areas. Any significant findings related to internal controls are included in the Audit Results section of the report.

We conducted this performance audit 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.

AUDIT RESULTS

Section A – Compliance

1. Administration and Accounting of Farmland Preservation Contributions

OBSERVATION

Compliance with MOU

Procedurally, the County and Chrin complied with the promises, covenants, and conditions provided for in the MOU with regard to properties sold in the Chrin TIF to date.

- ◆ Chrin accurately calculated the Farmland Preservation contribution based on the net sales price and made payments to Northampton County in a timely manner.
- ◆ The County promptly and properly deposited and recorded the contributions to the Farmland Preservation fund.

Sales Price

- ◆ We were able to verify the selling price of each of the parcels as stated on the settlement sheet with the County's deed records.
- ◆ We were unable to definitively assess whether the selling price reflected fair market value as many factors determine the final selling price. Each property has its own circumstances which determine the final selling price.
 - The attorney for the Chrin companies told us that for one parcel Chrin had to pay for site preparation as a condition of sale which raised the selling price of the land.
 - In another case, the bank holding the mortgage required 100% of the sale proceeds to cover the mortgage cost.

Closing Costs

- ◆ The largest component of closing costs in each parcel sale was the mortgage repayment cost while the next largest cost is the state transfer tax.
- ◆ We were not given permission to access Chrin's bank records or to contact Chrin's bank to independently verify the exact individual amount of each mortgage repayment cost listed on the settlement sheets for each parcel sold. Consequently, the net selling price for each individual parcel sold could not be validated. However, after examining the "Release of Mortgage" records on file with the Recorder of Deeds, we found that the **aggregate** mortgage costs listed on these documents was very close to the combined amounts listed on the settlement sheets.
- ◆ The attorney for the Chrin companies told us that there is an anticipation of paying down the debt on the remaining properties in the TIF earlier rather than later. He believes that future sales of parcels in the TIF could command a higher selling price than the parcels already developed now that the early developers have paved the way to establishing the area as a viable center of commerce. He indicated that commercial development for ancillary services in the TIF such as gas stations, restaurants, hotels and office buildings would likely be paying a premium for land as they would be buying smaller parcels in an established development. A higher selling price for the remaining parcels would cover the cost of what mortgage debt remains and potentially increase the net sales price, subsequently increasing the amount of the contribution to the County.
- ◆ The amounts of the state transfer taxes on the deed transfer sheets exactly matched the amounts on the settlement sheets. The transfer tax is a straight 1% of the selling price of the parcel. All amounts were calculated correctly.

RECOMMENDATION

We recommend that an annual report and analysis be prepared listing property sales, the components of the net sales price and the Farmland Preservation Contribution amount. An annual report from the information on the settlement sheets would allow comparison to previous land sales; serve as a planning tool for County management and a status report for County Council.

MANAGEMENT RESPONSE

James W. Hunter, Jr., Director of Fiscal Affairs

Going forward, an up-to-date report will be kept and updated with all property sales, the components of the net sales price and the Farmland Preservation Contribution amount. This information will be gathered from the settlement sheets thus allowing comparison to previous land sales and serve as a planning tool for County management and a status report for County Council.

Section B – Internal Controls

1. Administrative Responsibility of Farmland Preservation Contributions

OBSERVATION

Currently there is only one person in Fiscal Affairs that is familiar with the details of the MOU, works with the Chrin organization in administering the terms of each property sale and handles the accounting of contributions for the County.

RECOMMENDATION

The basis and operation of the program (including a summary of the key items in the MOU) should be documented, as should the recordkeeping of contributions. An additional person should be cross-trained in the background and procedures involved with the MOU in the event of the fiscal administrator's absence.

MANAGEMENT RESPONSE

James W. Hunter, Jr., Director of Fiscal Affairs

Management has begun to prepare a comprehensive procedure on the basis and operation of both the County's and Chrin's responsibilities as outlined in the Charles Chrin Real Estate Trust Memorandum of Understanding (MOU). This will include a summary of the key items in the MOU as well as the recordkeeping and disbursement of the contributions.

Furthermore, an additional person will be more thoroughly cross-trained in the background and procedures involved with the MOU in the event of the fiscal administrator's absence.