SC BUDGET AND CONTROL BOARD

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April 11, 2012

Dr. David A. DeCenzo, President
Coastal Carolina University
Post Office Box 261954
Conway, South Carolina 29528

Dear Dr. DeCenzo,

Recently I was directed by the Materials Management Officer, Mr. Voight Shealy, acting pursuant to procurement regulation 19-445.2022(B), to audit the University's agreements regarding its beneficial use of University Place and Campus Edge for compliance with the Procurement Code and to propose any appropriate corrective action. We appreciate the cooperation University staff has extended during our inquiry.

Our most salient conclusion is that certain agreements the University executed in 2002, 2003, and 2005, were made in violation of the South Carolina Consolidated Procurement Code. Of these agreements, the University continues to perform only one, the 2005 Student Housing Support Agreement. As reflected in the enclosed report, our recommendation is that you seek ratification of the 2005 Support Agreement.

Enclosed are two documents. The first is a draft report of our findings. We previously discussed certain aspects of this report with the University Counsel and your vice president for finance and administration. We have revised the report to reflect their comments. Some of the text is new. Please provide any additional comments to me so we may issue the report in final form no later than Wednesday, April 11, 2012. I can be reached at (803) 737-0647.

The second document is a written determination and request for ratification. Regulations in effect in 2005 required a written determination from the head of the governmental body supporting ratification of an illegal contract; accordingly, the written determination is drafted above your signature. In order to effectuate ratification, you will need to sign this document and return it to us at your earliest convenience. As you know, the Joint Bond Review Committee and the Budget and Control Board will consider later this month the University's request to lease all of University Place from the Foundation. We believe this matter needs to be resolved before the Committee and the Board consider the lease. The Committee's agenda deadline is Thursday, April 12, 2012; the Board's is Monday, April 16.

Sincerely,

Robert J. Aycock, IV, Manager
Audit and Certification

cc: Delbert H. Singleton, Jr., Division Director
R. Voight Shealy, Materials Management Officer
Lisa H. Catalanotto, Attorney, Real Property Services

Audit of Coastal Carolina University's Agreements Regarding University Place and Campus Edge
April 11, 2012

1. Introduction

Between 2003 and 2009, Coastal Carolina University ("CCU" or the "University") acquired the beneficial use of three residence hall facilities, comprising nearly 2100 beds. We have been provided no evidence that the construction or acquisition of any of these facilities was advertised to the public or that competitive bids were solicited. CCU Student Housing Foundation (the "Foundation") owns all three projects. In 2005 the Foundation created Coastal Housing Foundation, LLC (the "Company"). While the Foundation retains fee simple title to the projects, it leases them to the Company. The University is obligated under contracts it signed in 2005 and 2009 styled as "Support Agreements" to direct students to each project. In addition, the University manages all three projects under agreements that do not entitle the University to collect a management fee. The revenue stream from student rents supports debt service of bonds issued by South Carolina Jobs-Economic Development Authority ("JEDA"). Upon issuance of the last of the bonds in 2009, there was approximately $87,575,000 in principal amount of the Company's obligations. In 2012 the University seeks to convert its management and support of the residence halls into a lease. Under the proposed lease, the University must pay rent in an amount equal to what the Company must pay under the bond documents to repay the remaining bond debt.[1]

2. Facts

We have reviewed the bond transcripts from the 2005 and 2009 transactions; selected documents the University or the Foundation furnished to us from the 2002 and 2003 bond issues; and other documents from prior audits conducted by the Materials Management Office. University staff provided comments on an earlier draft of these findings. The following discussion draws from the documents reviewed and other information we received from the University.

a. University Place Phase I

The first project is called University Place. In September 2002, the Foundation entered into a Development Agreement with The Residence Group, LLC ("TRG"). TRG owned a fourteen-acre tract of land adjacent to the University campus. Under the terms of the Development Agreement TRG promised to convey the land to the Foundation and construct student apartments, "turnkey," on it.[2] The agreement includes the following recitals:

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[1] Under limited circumstances, the University's proposed lease provides for termination due to nonappropriations. Even if the lease is terminated, the University's obligation under the Support Agreements remain.

[2] For tax reasons, JEDA agreed to hold title to the real property until the Foundation obtained a determination from the IRS of its tax-exempt status. By mid-2003 the Foundation must have received the determination, because JEDA deeded the real property and improvements to the Foundation on July 30, 2003.

> .... Developer desires to develop a 517 bed-apartment style student housing facility (the "Project") in order to address the University's need for additional student housing.
>
> ***
>
> The Owner desires that the Developer undertake to develop, finance, design, construct, furnish and equip the Project on behalf of the Owner.

("Owner" initially referred to JEDA; after JEDA conveyed the property to the Foundation, "Owner" referred to the Foundation. See note 1, above.) The agreement further provides that "[t]he University has also reviewed and approved the Plans; the University's approval is indicated in the document attached hereto as Exhibit H." Exhibit H reads:

> I, Ronald R. Ingle as the duly appointed representative of Coastal Carolina University, do hereby and herewith approve the items outlined below as is required by the Development Agreement between The Residence Group, LLC and CCU Student Housing Foundation ....

Listed on the exhibit are "Final Construction Plans and Specs" and a change order to the construction contract. The Development Agreement does not indicate the total price for acquisition, design and construction of the project. However, the principal amount of tax-exempt bonded indebtedness, which was supposed to be spent on those items, was $19,880,000. Substantial completion was required no later than August 15, 2003. If TRG failed to complete construction on time, the agreement provided for TRG to incur significant additional expenses, including providing hotel lodging for students who otherwise would have roomed at University Place.

Included among the bond documents was a "Management Agreement" between JEDA and Pinnacle Property Management Services, LLC. Pinnacle never managed the project. University officials confirmed that the University assumed management of Phase I in May 2003, prior to its opening. The University, as manager, and JEDA and the Foundation, as owners, signed a Management Agreement dated May 13, 2003. Its recitals include:

> WHEREAS, [JEDA] and the Foundation entered into that certain Development Agreement ... with the Residence Group, LLC ... to acquire, design, construct, furnish, equip and operate a 517 bed student housing facility (the "Development") with 11 buildings and certain amenities located off South Carolina Highway 544 near Coastal Carolina University ... known as "University Place" ....

The Management Agreement charges the University to employ staff to manage, operate, and maintain University Place in the same manner as it does for student housing it owns. It prescribes minimum staffing levels. Among other specific obligations, it requires the University to:

- market the project, including advertising brochures

- prepare student leases and get them executed
- collect deposits and rents
- maintain the project [i.e., the facility] and its grounds
- prepare annual and capital improvement budgets
- make contracts for water, electricity, gas, telephone, data, CATV, internet, sewage and trash disposal, vermin extermination, snow removal and landscape care, and pay for those services from the operating account set up pursuant to the Agreement
- establish and maintain a comprehensive record-keeping system
- provide monthly and quarterly financial reports to the Foundation
- maintain insurance on the project

The University's direct expenses are to be paid through the Operating Account established in the bond documents. The Management Agreement provides for a baseline fee of four percent of "collected revenues" and an additional two percent of collected revenues if there is on deposit 120% of funds needed to service current bond debt. Neither of our audits attempted to confirm whether these fees reimbursed the University for all the actual expenses incurred or whether these fees were actually paid to the University.[3]

Also in September 2002, the University entered into a Student Housing Project Support Agreement with JEDA, the Foundation, and a bank involved in financing the bonds. The Support Agreement recites that

> [JEDA] will use the proceeds of the Bonds to finance the costs associated with the acquisition, construction, furnishing and equipping of a 517 bed student housing facility to be located near the University's campus (the "Project"). The indenture provides that [JEDA] will initially own and operate the Project as a student housing facility to be used solely by students and faculty of the University.
>
> ***
>
> The Project will provide much needed housing for the students of the University, will offer a housing option not previously available to students, and, therefore, will promote the University's educational purposes.
>
> ***
>
> To enhance the marketability of the Bonds, to achieve interest savings for [JEDA] and the Foundation that will result in lower rental rates for the University's students ... the University has agreed to enter into this Agreement.

The Support Agreement bound CCU to

[3] In a subsequent management agreement signed in 2009 the University agreed to perform all these services at cost. Again, neither of our audits attempted to confirm whether sufficient payments were made to actually reimburse the University for all the actual expenses incurred.

- Refer students to University Place
- Implement procedures to help students apply for residence in University Place
- Identify University Place as "Preferred Residential Housing" in all of the University's published literature and on its website
- Allow the Foundation and its property manager access to advertise on campus
- Provide to University Place tenants the same internet and intranet services and campus life programs as it does for students in University-owned housing

At the same time it prohibited the University from

- Operating, owning or supporting any other off-campus housing on a preferential basis to University Place
- Operating any new project, on or off campus, on a parity basis with the project[4]

With the Support Agreement, the University acquired a right of first refusal, should any third party offer to purchase the property. In addition, the University acquired an option to purchase the project itself for the balance of the bond debt and all other debts and obligations of the Foundation relative to the project. Regarding the duration of its obligations, the University cannot terminate the Support Agreement so long as any bond debt remains outstanding.[5] The Foundation's interest in the Support Agreement is included as security for the mortgage it gave in connection with the bonds. Section III of the mortgage's Granting Clause includes "[a]ll ... agreements relating, directly or indirectly, to the use or occupancy of all or any portion of the Land and/or the Improvements ... created by or on behalf of the Foundation ...."

b. University Place Phase II

A year later the Foundation entered a second Development Agreement with TRG. The deal was simpler this time, presumably because the Foundation's tax-exempt status was secure and there was no need for JEDA to hold title to the real estate. Otherwise, the agreement is nearly indistinguishable from the 2002 contract; all of the rights and obligations identified above also appear in the 2003 agreement. TRG owned twelve and a half acres next to the first phase of University Place. It promised to convey that land to the Foundation and deliver a slightly smaller facility. The 2003 recitals include these:

> .... Developer desires to develop a 470 bed-apartment style student housing facility (the "Project") in order to address the University's need for additional student housing.

[4] With the bond trustee's consent, the University could develop other housing if it established, through market analysis and certification by independent consultants, that the new facility would have no adverse effect on the ability of the University Place rental income to cover the bond debt. Similar language appears in the Support Agreements executed in 2003, 2005, and 2009.

[5] The agreement provides that it "shall remain in full force and effect so long as the Letter of Credit of the Bank is currently in effect." The letter of credit is a component of the "Credit Facility" required under the Loan Agreement in the bond transcript. The Foundation must maintain the Credit Facility, including the letter of credit, until the bond debt is refinanced, paid in full, or defeased—effectively, until there is no remaining debt from the Series 2002 Bonds.

***

> The Foundation enters into this Development Agreement with the Developer to set forth the parties' understanding regarding the development, finance, design, construction, furnishing, and equipping of the Project by the Developer on behalf of the [Foundation].

Phase II shared its designer and contractor with Phase I, and JEDA provided the financing. The tax-exempt portion of the 2003 bond issue was $18,225,000. Again, the University approved the plans in an exhibit to the agreement.[6]

Like the 2002 bond issue, the 2003 bond issue also required a housing Support Agreement. Like the Development Agreement, the 2003 Support Agreement no longer included JEDA as a party. It did, however, reflect that University was entering into a management agreement with the Foundation for Phase II. The Support Agreement also added the following obligation for the University:

> The University covenants to take those actions, at its discretion, necessary to ensure an occupancy ratio of the Project adequate to maintain a Debt Service Coverage Ratio required [by the bond documents].

Immediately following the description of this covenant was a disclaimer that the University was in no way liable for the bond debt. Except for these changes, the 2003 and 2002 agreements are the same. That is, the University remained obligated, among other things, to direct a stream of student tenants to University Place; to provide for internet access; to market the project; and—so long as the debt remained outstanding—not to compete with it. The 2003 mortgage includes the Foundation's interests in the Support Agreement.

In connection with the 2003 bonds the University and the Foundation signed a "Phase II Management Agreement." The Management Agreement is undated except for the year (2003). Its recitals include:

> WHEREAS, the Foundation anticipates entering into a Phase II Development Agreement ... with the Residence Group, LLC ... to acquire, design, construct, furnish, equip and operate a 470 bed student housing facility (the "Development") consisting of buildings and certain amenities located off South Carolina Highway 544 near Coastal Carolina University ... known as "University Place, Phase II"; and that it is the intent of the said parties that additional beds may be added to the Development in possibly one (1) further phase ....

In nearly every other respect, the Phase II Management Agreement is identical to the contract to manage Phase I. Under both agreements, the University must hire staff and manage,

[6] Inasmuch as the activities of the Foundation are beyond the scope of our audit, we express no opinion in this report whether the Foundation's acquisition of University Place, or the actual construction itself, was subject to the provisions of the Procurement Code pursuant to Section 11-35-40(4).

operate, and maintain University Place in the same manner as it does for student housing it owns. Like Phase I, in Phase II the University is obliged, among other things, to:

- market the project, including advertising brochures
- prepare student leases and get them executed
- collect deposits and rents
- maintain the project and its grounds
- prepare annual and capital improvement budgets
- make contracts [on the Foundation's behalf] for water, electricity, gas, telephone, data, CATV, internet, sewage and trash disposal, vermin extermination, snow removal and landscape care, and pay for those services from the operating account set up pursuant to the Agreement
- establish and maintain a comprehensive record-keeping system
- provide monthly and quarterly financial reports to the Foundation
- maintain insurance on the project

The University's expenses are to be paid through the Operating Account, as in Phase I. The Phase II Agreement provides for the same payments as in Phase I, although – as noted above - our audits have not attempted to confirm the receipt or adequacy of those payments.

c. 2005 Refunding and Restructure

On August 18, 2005, the Foundation created Coastal Housing Foundation, LLC (the "Company"). The Company's Articles of Incorporation were filed with the South Carolina Secretary of State on October 11, 2005. According to its Operating Agreement, dated October 1, 2005, the Company was

> organized by the Foundation solely as a single purpose entity exclusively for charitable purposes and essential governmental endeavors relating to the University, the Foundation and student housing for the University as set forth herein.

The Company's activities are limited to

> the business of financing, leasing, development and management of student housing facilities for the benefit of the University and the Foundation. In connection with such limited purpose, the Company may purchase, own, finance, lease, sell, develop, manage and operate real and personal property incident to its purpose described herein.

The Foundation is the sole member of the Company. In the operating agreement, the Company is specifically empowered

> to execute, deliver and perform the Master Indenture and any documents contemplated thereby or related thereto, including, without limitation, any documents related to the Bonds, and any amendments thereto, without any further

act, vote or approval of any Person, notwithstanding any other provision of this Agreement.

The Operating Agreement defines "Bonds" thus:

> The not exceeding $46,000,000.00 principal amount South Carolina Jobs-Economic Development Authority Student Housing Refunding Revenue Bonds (Coastal Housing Foundation, LLC Project), Series 2005A, and any other bonds, notes or other obligations issued by, on behalf of, or for the benefit of, the Company, from time to time, which bonds, notes or obligations, may be issued as obligations the interest on which is excludable from gross income of the holders thereof for federal income tax purposes.

In 2005 JEDA combined the bond debt from both phases and refinanced it, for a total of just over $38,000,000.[7] At the same time, the Foundation restructured the deal. Although the Foundation retained title to University Place, it leased the project to the Company. Rent was $32.8 million dollars, the amount necessary to retire the 2002 and 2003 bond debt, payable at execution of the lease, and one dollar per year thereafter. The term of the lease was the earlier of forty years, or discharge of all amounts due under the bonds. Since the new 2005 Support Agreement provided for the University to acquire the project by paying off the bonds, that acquisition would also terminate the lease. Simultaneous with execution of the lease and related bond documents, the Company gave a mortgage of its leasehold interest, including all rents and its rights in the new 2005 Management and Support Agreements, to the bond trustee. In other words, the Company borrowed the 2005 bond proceeds and used the money, in the form of rent, to pay off the Foundation's debt.

The 2005 refinance also involved the University's executing a new Student Housing Support Agreement which covered both Phases I and II of University Place. The Support Agreement, dated October 1, 2005, reflects the structural change created by the Foundation's lease to the Company and other formal differences between the 2002 and 2003 bond issues, on the one hand, and the 2005 bond documents, on the other.[8] Other than substituting the Company for the Foundation, the only substantive difference between the 2005 Support Agreement and its predecessors is the omission of this sentence from the University's responsibilities: "The University shall not provide security services to the Project ...." All of the University's obligations from the earlier agreements remained in force: It still directed students to University Place on a preferred basis; it still covenanted to use its best efforts to keep occupancy levels adequate to maintain the Company's debt service coverage at the rate required in the bond documents; it continued to provide internet access; and it was still prohibited from competing against University Place. In addition, the 2005 Support Agreement may not be terminated so long as the bonds are outstanding. Apparently, the University would now also provide security for the project. The 2005 agreement not only superseded the two prior support agreements: it actually added to the University's responsibilities.

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[7] The tax-exempt portion was $37,220,000; the taxable part was $875,000.

[8] For example, the bond trustee is not a formal party to the 2005 agreement, although it is identified in one of the recitations.

As part of the 2005 transaction the Company and the University signed a new Management Agreement covering all of University Place. Like the Support Agreement, it is dated October 1, 2005. It reflects changes in the bond documents from 2002 and 2003, and the appearance of the Company as Lessee. It also changes the way operating expenses were paid. Under the prior agreements the University paid the expenses it incurred in managing University Place from an Operating Account established for that purpose. Beginning with the 2005 contract, the University was required to pay the project expenses – presumably out of its own funds; the Company would reimburse the University twice annually, pursuant to invoices the University could submit on June 15 and December 15 each year. The 2005 Agreement provided for a management fee, but subordinated it to payment of the bonds. Only if sufficient revenue remained after payment of all the Company's "Master Obligations" would the University receive a fee.[9]

After the 2005 bond issue closed, the Foundation held fee simple title to University Place Phases I and II; the Company leased the project for the term of the bonds; the Company's lease and other interests in the project were subject to a mortgage in favor of the bond trustee; the University was party to a new Support Agreement; and the University was installed as manager of both Phase I and Phase II.

Effective July 16, 2007, Campus Advantage, Inc., took over management of University Place. The Company's agreement with Campus Advantage included an annual management fee of $232,484. It also provided that project expenses would be funded from collected revenues, instead of being advanced by the manager; and that the Company would wire money into the operating account if there were not sufficient funds to cover Campus Advantage's project expenses.

d. Budget & Control Board Audits

In February 2008 the Budget & Control Board published the results of its audit of the University's procurements for the period July 1, 2004, through June 30, 2007. Part of the audit addressed the Support Agreement and Management Agreement associated with the 2005 bond refinance. The audit concluded that, since the University had failed to comply with the Consolidated Procurement Code, both agreements were illegal. Additionally, the audit found that maintenance and repair contracts for University Place between the University and third parties were not competed in accordance to the Code.

The University's response to the auditors' findings, included in the February 2008 report, concluded with this statement:

> [T]he University accepts the finding that the Code applies to every expenditure of funds through the University that are not expressly exempt from the Code, irrespective of the source of funds. The University will comply with the Code for all these types of contracts.

[9] Again, our audit did not determine whether the Company ever paid any management fees to the University nor whether the reimbursements received by the University covered all the costs it actually incurred in maintaining and managing the facilities.

Our auditors recommended the Budget and Control Board reduce the University's procurement certification by half, which the Board did on May 13, 2008.

e. Change in Management

The Company terminated its agreement with Campus Advantage two years after it began and re-signed with the University. The new Management Agreement, dated July 24, 2009, is plainly patterned after the 2005 contract. It returns to the arrangement where the University advances management expenses and invoices the Company twice a year for reimbursement. There are two significant differences from previous agreements. First, the University undertook "to provide for shuttle service across campus," to be billed as an operating expense. Second, it expressly waived any fee for managing the project:

> Since this agreement is a mutual benefit arrangement between the Company and Manager for the benefit of the Company, the University, and the students of Coastal Carolina University, the parties hereto have agreed that no compensation shall be due and payable by the Company to the Manager for its management and related services rendered under this Agreement.

Based on the prior contract with Campus Advantage, the value of the waived fee was over $230,000 annually. The 2009 agreement does not entitle the University to interest on the amounts it advances for its costs and expenses of managing University Place.

f. 2009 Acquisition of Campus Edge

In 2009 the Foundation purchased improved real property adjacent to University Place described as four parcels, including nineteen buildings comprising an apartment project called Campus Edge. The property description corresponds roughly to land that has changed hands several times since 2004. On January 22, 2007, Apex Contracting, Inc., filed a Notice of Project Commencement.[10] Real property records available online do not indicate if any construction had been performed before Apex filed its notice, or when Apex finished the project. According to the Official Statement in the 2009 bond transcript, all the buildings in Campus Edge were completed before December 2009. At that time the facility was at least partially occupied.

The buildings in Campus Edge are arranged similarly to those in University Place. That is, they include 300 apartment units of two, three and four bedrooms with floor plans typical of student housing. Being material to our overall review, we inquired with the University whether it had any direct or indirect involvement in construction of Campus Edge or in the approval of its design; University officials represented to us that neither the University nor the Foundation were involved. It appears that a private developer acquired the land, procured the designs, and engaged a general contractor to build apartments, hoping to profit from the growing market for student housing near the University's campus. By deed recorded December 30, 2009, Campus Edge Apartments at Conway LLC sold Campus Edge to the Foundation. As with University Place, the Foundation leased Campus Edge to the Company. The purchase price for Campus Edge was just under $43,000,000. It was funded by a single lease payment from the Company to

[10] A Notice of Project Commencement is authorized by Code Section 29-5-23. Its purpose is to afford a general contractor protection from mechanics' lien claims by remote materialmen or subcontractors. It must be filed within fifteen days of the commencement of construction work.

the Foundation, made from the proceeds of revenue bonds valued at just over $52,000,000. According to the Official Statement, "[u]pon issuance of the Series 2009 Bonds, there will be approximately $87,575,000 in principal amount of Outstanding Master Obligations of the Company under the Master Trust Indenture." Repayment of the bonds is secured by a mortgage on the Company's lease and its interest in the rents and other contracts, including the 2005 Support Agreement, the July 24, 2009 Management Agreement for University Place, and a new Support Agreement and Management Agreement, both regarding only Campus Edge and both executed as part of the bond issue.[11]

The December 1, 2009, Student Housing Project Support Agreement defines the "Project" as Campus Edge. Its provisions are largely similar to the 2005 Support Agreement for University Place Phases I and II, with two exceptions. In 2005, the University's policy was to require freshmen to live on its physical campus. Since University Place was off campus, freshmen were not referred there. By December 2009 the University had modified its policy to require freshmen *and* sophomores to live in campus housing. The 2009 Support Agreement designates both University Place and Campus Edge as "campus housing for the purpose ... of meeting the freshman and sophomore student housing residency requirement."

The 2005 Support Agreement – which regarded only University Place - remained in force. It provided the University with the option to purchase University Place for an amount not less than the outstanding bond debt. The 2009 Support Agreement removes the option. It provides that

> [f]or as long as the Bonds or any refunding obligations are outstanding, the University will not purchase the adjacent student housing known as "University Place" pursuant to the terms of that certain Support Agreement dated as of October 1, 2005 among the Parties hereto ....[12]

Both the Foundation and the University were concerned that certain aspects of the 2009 transaction might implicate the Consolidated Procurement Code. It is not clear, though, if the compliance concern was with the acquisition of Campus Edge, or with the University's execution of the Support Agreement or Management Agreement. The University prepared a "Justification for Sole Source Procurement." It recites that the University "proposes to acquire a housing support agreement as a sole source from [the Company] and [the Foundation], on the basis of Section 19-445-21.5.B.(5) *[sic]* of the South Carolina Code of Regulations: where the item is one of a kind." It is drafted to comply with the Code's requirement of a determination justifying the use of sole source procurement, on a form prescribed for that purpose by the Materials Management Office. The determination is dated December 14, 2009, and is signed by the University's Senior Vice President of Finance and Administration.[13] The determination does not indicate a dollar value for either Campus Edge or the Student Housing Support Agreement. In its required quarterly report of sole source procurements to MMO, the University identified

[11] The University had entered into a management agreement with the Company for University Place (Phases I and II) on July 24, 2009. We do not have a copy of that agreement, but it was superseded by an "Amended and Restated Management Agreement" dated May 6, 2010.

[12] We have been unable to determine the justification for this provision.

[13] A different individual now occupies this position at the University.

the procurement of a "Housing support agreement" from Coastal Housing Foundation. In the "Dollar Amount" column, it listed "n/a." The purchase price for Campus Edge was nearly $43,000,000.

g. 2010 Amended and Restated Management Agreements

The University and the Company replaced the 2009 Management Agreements for University Place and Campus Edge with "Amended and Restated Management Agreement[s]." Both new agreements are dated May 6, 2010. Except for specific references to the different projects and bond issues, and the amendment provision discussed below, the Campus Edge document is verbatim the same as the University Place management agreement. The 2010 Agreements make small changes throughout. For example, they refer to Campus Edge as "University Place Phase III" and define all three phases as the "University Place Facilities." They change the description of Phases I and II from "near campus" to "on campus." They allow the consolidation of operating budgets for University Place and Campus Edge, for as long as the University manages both. They require more frequent and more detailed financial reporting requirements, and demand them sooner than the contracts they replaced. The terms of both agreements run until December 30, 2010 and are renewable on a month-to-month basis thereafter; the older agreements renewed annually unless terminated. Under the amended agreements, the University incurs expenses and advances costs for six months before reimbursement. Both restated agreements include the University's promise, in Section 10, to manage without fee.[14]

Finally, the amended agreement requires the University to compete certain specified contracts, and all contracts exceeding $25,000:

> (n) *Third-Party Service Contracts and Capital Expenditures.* The Manager shall employ personnel and contract for services and capital purchases for the University Place Facilities in the most cost effective way to insure quality management and operation of the Project. The Manager will endeavor to obtain three quotes for services and capital purchases and submit a recommendation to the Company for all contract amounts in excess of $25,000 per year. The Manager shall comply with all applicable laws in connection with entering into such purchasing contracts. All contracts will be for no more than one year in duration and contain a 30-day cancellation provision at no cost unless otherwise approved by the Company. Multiple contracts for the same service or similar items will be treated as one contract under this provision.

If this procedure were followed such that needed supplies, services, construction, and information technology were acquired pursuant to contracts between the University and the

[14] The University recently provided us with a "grant letter" dated December 30, 2009. In the letter the Foundation agrees to donate money to in the form of a "grant." All donations are contingent on the existence of a surplus of funds remaining after all management expenses are paid and the Company's bond debt and other obligations are satisfied. The Foundation may terminate the grant letter at its discretion, after notice to the University; and the Company may at any time establish a higher threshold for triggering the grant. University officials have told us that the University has received monies from the Foundation pursuant to the grant letter. Confirming the existence or amount of these payments was beyond the scope of our inquiry.

third-party vendors, those contracts would be subject to the Procurement Code. University officials have represented to us, however, that actual practice varies from the procedure in the Management Agreement; the University does not contract with third parties for any of the services at the projects. Rather, the University assists the Company in placing those contracts; and, according to University officials, the actual agreements reflect that the Company, not the University, is a party. Payments to these contractors are made by check drawn on a bank account owned by the Company. A University official has signatory authority for the account, manages accounts payable to the vendors, and prepares and remits payments to them.[15]

3. Analysis

The South Carolina Consolidated Procurement Code ("Procurement Code") appears in Title 11, Chapter 35 of the South Carolina Code of Laws. Because the Procurement Code is remedial in nature, it must be liberally construed in order to effectuate its purpose. *Sloan v. Greenville County*, 356 S.C. 531, 590 S.E.2d 338 (Ct. App. 2003) ("The County's procurement code is remedial in nature, and its provisions should be construed liberally to carry out its purposes."). Establishing an open and competitive public procurement system is one of the Procurement Code's expressly stated purposes. § 11-35-20(b); *Charleston County School District v. Leatherman*, 295 S.C. 264, 368 S.E.2d 76 (Ct. App. 1988) ("This code section clearly specifies the legislative intent to provide a system of competitive procurement laws."). The fundamental objective of a public procurement system is "to give all persons equal right to compete for Government contracts; to prevent unjust favoritism, or collusion or fraud in the letting of contracts for the purchase of supplies; and thus to secure for the Government the benefits which arise from competition." *United States v. Brookridge Farm, Inc.*, 111 F.2d 461, 463 (10th Cir. 1940). To achieve this objective, procurement laws "should receive a construction always which will fully effectuate and advance their true intent and purpose and which will avoid the likelihood of same being circumvented, evaded, or defeated." *Wester v. Belote*, 138 So. 721 (Fla. 1931) (citing authority from numerous jurisdictions) (quoted by *Letter to Senator Waddell*, 1984 S.C. Op. Att'y Gen. No. 84-8 (1984 WL 159817)). "[A]gencies cannot escape the requirements of the [Procurement Code] by involving a third-party for the purpose of general construction responsibilities or for the purposes of obtaining the necessary funding." *Affiliated Construction Trades Foundation v. University of West Virginia Board of Trustees*, 557 S.E.2d 863, 879 (W. Va. 2001).

a. Applicable / Prior Law

Our focus is on the Management Agreements and Support Agreements executed in 2002, 2003, and 2005. The law governing those agreements is the law in existence at that time. *Cf. Inabinet v. Roay Exchange Assur. of London*, 162 S.E. 599 (S.C. 1932) ("Every contract entered into in this state embodies in its terms all applicable laws of the state just as completely as if the contract expressly so stipulated."). This rule applies equally in the government context. *City of North Charleston v. North Charleston Dist.*, 346 S.E.2d 712 (S.C. 1986) ("It is a fundamental rule of contract construction that the law existing at the time and place of the making of a contract is a part of the contract. This rule applies in the area of governmental contracts.")

[15] We offer no comment regarding this practice, and our silence should not be considered approval.

(citations omitted). Accordingly, the version of the Procurement Code applicable to the agreements is the version in effect when the University signed them.[16]

Prior to its amendment in 2006, Section 11-35-40(2) provided that the Procurement Code "shall apply to every expenditure of funds by this State under contract acting through a governmental body as herein defined irrespective of the source of the funds...." The term "contract" was defined to mean "all types of state agreements, regardless of what they may be called, for the procurement...of supplies, services, or construction." § 11-35-310(8). In pertinent part, the term "procurement" was defined to mean "buying, purchasing, renting, leasing, *or otherwise acquiring* any supplies, services, or construction." § 11-35-310(24) (emphasis added). The term "construction" was defined to mean "the process of building...any...public structure...of any kind to any public real property."[17] § 11-35-310(7). Read together, and absent an exemption,[18] the Procurement Code applied to every expenditure of funds by a governmental body pursuant to an agreement for an acquisition of the process of building, excluding acquisitions by inter-governmental contract or by state-issued grants.[19]

Following the University's execution in September 2002 of the Student Housing Support Agreement, and its concurrent approval of the Phase I design drawings, Chancel Construction constructed University Place Phase I. Presumably, some construction was still being performed in May 2003 when the University entered into the Management Agreement for Phase I. When construction ended, the University's students and management staff moved into the new buildings. Likewise, following the execution of the management and support agreements in September 2003, Chancel built Phase II. The University thus acquired construction of University Place.

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[16] Although there were slight differences in the Procurement Code then, application of current law would entail a similar analysis and result in the same conclusions.

[17] Amendments to the Code in 2008 eliminated the reference to "public" real property in the definition of "construction." We do not believe the previous reference is significant in this case. The former definition did not reference publicly-*owned* real property or otherwise require that the University hold the fee or any other legally recognized interest in real property. In the matter under review, the University obtained an option to purchase the property; was contractually obligated to treat the property as its own; refers its students to the property on the same basis as housing it owns; and the use of the property is limited to the University's faculty, employees and students. For purposes of the Procurement Code, University Place became public real property.

[18] See, e.g., S.C. Code Ann. § 11-35-710.

[19] In addition, the Procurement Code does not apply to the acquisition of solely an interest in real property, e.g., land, including pre-existing (i.e., not built-to-suit) improvements and fixtures, or lease-hold estates, including complementary subordinate services. The Consolidated Procurement Code was first enacted on July 30, 1981. As originally enacted, the Code applied to transactions solely for a lease of real property, but did not apply to transactions solely for the purchase or sale of other interests in real property. 1981 Act No. 148, eff. July 30, 1981 (defining the term "supplies" as "all personal property, including but not limited to equipment, materials, printing, insurance *and leases of real property, excluding real property or an interest in real property other than leasehold interests.*") (italicized language removed by 1997 Act No. 153). Specifically, real property leases were governed by Section 11-35-1590, which provided that "[n]o governmental body shall enter into any lease agreement or renew any existing lease except in accordance with the provisions of this Section." Section 11-35-1590, and related Section 11-35-1600, were repealed by 1997 Act No. 153, eff. June 13, 1997. Currently, the procurement code applies to a real property lease only if the transaction also involves a significant acquisition of supplies, services, information technology, or construction (e.g., lease/purchase of custom-built, new construction). In 1997, Sections 11-35-1590 and -1600 were re-codified, separate from the Procurement Code, as Sections 1-11-55 and 1-11-56, respectively. 1997 Act No. 153.

Pursuant to the 2002 and 2003 Management Agreements, the University collected funds (security deposits and rents) from student tenants and, in accordance with provisions of those agreements and the bonds, maintained them in accounts for security deposits, rental revenue, repair and replacement, and operations contingencies. The University paid those funds, net of the University's expenses, directly to the Foundation. The procedure under the 2005 Management Agreement was the same, except the University paid the funds to the Company. Under all three agreements, there was an "expenditure of funds" to the Foundation or the Company; "under contract," *i.e.,* the Management Agreements; "by this State...acting through a governmental body," the University. Taken alone, then, these expenditures trigger application of the Procurement Code.

Aside from the University's payments to the Foundation and the Company, all three Management Agreements contractually obligated the University to pay funds to third parties. The University used a portion of the funds it collected from students to pay third party vendors for a variety of expenses necessary for the facility's operations and maintenance. The 2002 and 2003 Management Agreements expressly required the University to "purchase all materials, equipment, tools, appliances, supplies and services for proper maintenance and repair of the [project]." They also obligated the University to "execute any necessary agreements for water, electricity, gas, telephone, data, CATV, sewage and trash disposal, vermin extermination, snow removal, and landscape care." The 2005 Management Agreement contains identical language. Similarly, the 2005 Support Agreement requires the University "[t]o provide to students residing in the Project equal internet and intranet services and campus life programs it provides to students in its own housing facilities...." The 2002 and 2003 Support Agreements also required internet access for students, but "[a]t no cost to the University." Whether its students reimbursed the University for its cost to provide internet connectivity does not change the fact the University must have paid for the service in the first instance. Since the University expends funds for those services, the requirement for an "expenditure of funds by [the] State" is satisfied. Nothing in the Code requires that the payment be made directly to the party with whom the state has an agreement, only that there be an expenditure by the State under contract

The Procurement Review Panel used a similar analysis in *In Re Protest of Wometco Food Services, Inc.*, No. 1991-14 (Procurement Review Panel, dated Sept. 2, 1991). In that case, the Panel considered an arrangement where a vendor provided student dining services pursuant to a contract with Tri-County Technical College. The agreement there did not obligate the college to pay anything directly to the vendor (in fact, the vendor was to pay the college for the privilege of selling food to students). It did, however, require the college to furnish services like utilities and pest control—services which the college necessarily paid third parties to provide. The Panel concluded these payments were sufficient to bring the agreement within the purview of the Procurement Code.

Whether or not all the funds collected by the University ultimately belonged to it is not determinative; funds did not need to be "state" funds to trigger application of the code. In 2002, 2003, and 2005 the Code applied no matter the source of the funds. The Procurement Review Panel's decision in *Wometco* illustrates this analysis. Wometco challenged the jurisdiction of both the Chief Procurement Officer and the Panel to hear a protest arguing, among other things,

that county funds, not state funds, were used to pay for certain of the College's obligations. The Panel dismissed this argument:

> Both Wometco and Atlas refer to "the expenditure of state funds" as the pivotal requirement of the Code. In fact, the language is "expenditure of funds by this State under contract acting through a governmental body as herein defined irrespective of the source of funds....
>
> Dr. Garrison testified that county funds were used to provide support services to the winning vendor. Defendant's Exhibit 5 and the testimony of Thomas Lewis, the Vice President for Finance of the College, indicate that these funds are part of the College's expenditure budget. Because the College is a governmental body, as defined in §11-35-310 (18), these county funds when spent through the College become "expenditures of funds by this State" as defined in §11-35-40.

Wometco.

Applying the Procurement Code to the 2002 and 2003 Support Agreements and Management Agreements is particularly appropriate given, among other facts, that the University expressly approved the building plans of both phases; the University had no business interest in providing housing management services to a private concern, other than to facilitate housing for its students; the University contractually obligated itself to spend funds; and, the University granted a private firm—the Foundation—the exclusive right to earn revenue through its contract with a public agency. *See*, *generally*, *Protest of Wometco Food Services, Inc.*, Case No. 1991-14 (Procurement Review Panel, dated Sept. 2, 1991); *Letter to Racine D. Brown*, S.C. Att'y Gen. Op. of Jan. 8, 1982 (1982 WL 189234); *Letter to T.W. Edwards, Jr.*, S.C. Att'y Gen. Op. of Aug. 4, 1987 (1987 WL 342394); *Brasi Dev. Corp. v. Attorney Gen'l*, 925 N.E.2d 826 (Mass. 2010); *Andrews v. City of Springfield*, 915 N.E.2d 1133 (Mass. App. Ct. 2009); *Affiliated Const. Trades Found. v. University of West Virginia Bd. of Trustees*, 557 S.E.2d 863 (W. Va. 2001); *Mechanical Contr. Ass'n of Cincinnati, Inc. v. University of Cincinnati*, 750 N.E.2d 1217 (Ohio Ct. App. 2001); *Department of Gen'l Svcs. v. Harmans Assoc. Ltd. P'ship*, 633 A.2d 939 (Md. Ct. Spec. App. 1993).

In 1984, the South Carolina Attorney General concluded that the Procurement Code applied to a somewhat similar arrangement. *Letter to Senator Waddell*, 1984 S.C. Op. Att'y Gen. No. 84-8 (1984 WL 159817). In that opinion, the Attorney General discussed Clemson's proposal to lease certain parcels of land to a non-profit corporation whose principal purpose was the support of Clemson. The corporation would then contract with a developer to construct the Strom Thurmond Institute and numerous hotel suites and townhouses that the corporation would lease or sell to the general public. It was anticipated that the land would eventually return to Clemson's ownership. Even though the development contract would be between the corporation and the developer, Clemson was the principal beneficiary of the contract and would have a major role in its negotiation. Clemson was "lending its name, as well as the exclusive use and enjoyment of a portion of its property, and [] granting [an] exclusive right to make a substantial

profit from the development of that property" in return for some rental compensation and the development of a multi-use complex.

After describing the transaction, the opinion reviews numerous state court opinions which address the appropriate application of procurement laws. The Attorney General's opinion, and its review of the case law, supports the conclusion that the Procurement Code applies to any transaction in which "the work performed [is] in essence being done for the benefit of the public body and its costs simply passed along to others...." In concluding that the Procurement Code governed Clemson's proposed agreement, the Attorney General also found it important that "Clemson [was] granting the exclusive right to develop its campus and the corresponding right to profit thereon." *See, also, Letter to Michael T. Rose*, S.C. Att'y Gen. Op. of April 4, 1996 (1996 WL 265496) (affirming 1984 opinion).

b. Current Law

Section 11-35-40 currently provides that the Procurement Code "applies to every procurement or expenditure of funds by this State under contract acting through a governmental body . . . except that this code does not apply to gifts, to the issuance of grants, or to contracts between public procurement units, except as provided in Article 19 (Intergovernmental Relations)." § 11-34-40(2). In pertinent part, the term "procurement" is defined to mean "buying, purchasing, renting, leasing, or otherwise acquiring any supplies, services, information technology, or construction." § 11-35-310(24). The term "contract" means "all types of state agreements, regardless of what they may be called, for the procurement . . . of supplies, services, information technology, or construction." § 11-35-310(8). The term "construction" is defined as "the process of building ... any ... public improvements of any kind to real property." § 11-35-310(7). Read together, and absent an exemption,[20] the Procurement Code today—just as it did before the 2006 and 2008 amendments—applies to virtually every acquisition pursuant to an agreement by a governmental body, excluding acquisitions by gift, by inter-governmental contract,[21] or by state-issued grants.[22]

In 2002 and 2003, through functionally identical transactions, Coastal Carolina University acquired the construction and beneficial use of a built-to-suit facility (University Place), incorporated it into its existing inventory of student housing facilities, and relied on it to satisfy its general need for additional campus housing, all pursuant to its agreements with CCU Student Housing Foundation. As those agreements did not memorialize an acquisition by gift, inter-governmental contract, or state-issued grant, this acquisition – if conducted today – would be subject to the requirements of the Procurement Code, as they exist today.

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[20] Regarding exemptions, see footnote 18 above. Regarding transactions involving an interest in real property, see footnote 19 above.

[21] The Procurement Code applies to intergovernmental agreements as provided in Article 19 (Intergovernmental Relations) of the Procurement Code. S.C. Code Ann. § 11-35-40(2).

[22] As noted above, the Procurement Code applies to procurements. Contrast the Code's definitions of the term "grant" with the term "procurement." S.C. Code Ann. § 11-35-310 (19) & (24).

4. Conclusions and Recommendations

Consistent with these opinions, the above cited legal authorities, and the facts outlined above, we conclude that the 2002 and 2003 Management Agreements and Student Housing Support Agreements were entered in violation of the Procurement Code.[23] Contracts made with disregard to the Code are void. *See, generally, Charleston Television, Inc. v. South Carolina Budget and Control Board*, 392 S.E.2d 671 (S.C. 1990) ("Therefore, the only logical conclusion is that the lease was entered into in contravention of § 11-35-1590(3)(c) and is therefore null and void."). Those agreements, however, are no longer in force. The Support Agreements expired in 2005 when the 2002 and 2003 bond debt was retired.[24] The separate management contracts for Phase I and Phase II were combined into a single Management Agreement covering all of University Place. In the 2005 management and support agreements the Company, as tenant, replaced the Foundation. From the University's perspective, though, little changed. It continued to manage both phases of University Place. It still paid the bills for the project, and turned over the balance of rents to a private firm. Its covenants to direct student tenants to the project, and not to compete with the project by developing other housing, remained in force. Only the payee's name on the checks the University wrote for net operating income was different. Stated another way, had the Foundation not elected in 2005 to refinance and restructure University Place, the 2002 and 2003 agreements would still be operative and the University would be conducting its business exactly as before.

More importantly, the 2005 refunding would never have closed without the University's willingness to execute a new Student Housing Support Agreement. The commitments from Coastal, memorialized in the first two Support Agreements, were critical at the projects' genesis. Without them the Foundation could not have secured bond financing, certainly not for the rates agreed upon, and neither project would have been built. But for the University's agreements in 2002 and 2003 there would be no University Place. If the University had refused to sign the 2005 Support Agreement, its obligations under the 2002 and 2003 contracts would not have been satisfied, and those agreements would still be in force. The Foundation's refinancing a couple years later did not "purge" the illegality. The 2005 agreements merely supplanted their previous counterparts. They cannot be evaluated outside the context of the earlier transactions.

The bond issues of 2005 and 2009 both depend in part on the promises expressed in the 2005 Student Housing Support Agreement. The 2005 series bonds also relied on the University's covenants in the Management Agreement. The Management Agreement, however, was terminated by the parties on August 27, 2007. It furthers no interest of the State to call the validity of these bonds into question, and that has not been the purpose of our review. The

[23] In the 2009 transaction, the University acquired beneficial use of Campus Edge. Since Campus Edge was an existing permanent improvement, we do not have sufficient information to characterize the 2009 support agreement as a contract for acquisition of construction. The University prepared a timely written sole source justification for this agreement. Accordingly, we do not analyze the applicability of the Procurement Code to the 2009 housing support contract. Given the unique circumstances involved, we have no reason to question the University's decision. Nevertheless, the propriety of the sole source acquisition is beyond the scope of this audit.

[24] The agreements were effective only as long as the letters of credit securing repayment of the bonds remained in effect. When the refunding closed in 2005, the 2002 and 2003 series bonds were retired and those letters of credit expired, simultaneously terminating the corresponding Support Agreements.

State's interests here are served by cleaning up the problems created by the University several years ago, and instituting controls at the University to prevent future violations of the Code.

These problems were created by the University prior to the 2006 Code amendments, and corresponding changes in Regulations the following year. At that time, Regulation 19-445.2015 provided a procedure whereby the Director of General Services could ratify an agreement unauthorized by the Procurement Code.[25] Our recommendation is that the University submit a written determination pursuant to what was then R. 19-445.2015A(3) and request, in accordance with that regulation, a ratification of the 2005 Student Housing Support Agreement. Further, we recommend that the Director grant the request and affirm the contract. A proposed written determination, as required by the regulation, and request for ratification, is attached.

[25] Prior to the changes in 2007, this regulation read as follows:

A. Unauthorized Procurements.

The ratification of an act obligating the State in a contract by any person without the requisite authority to do so by an appointment or delegation under the procurement Code rests with the Office of General Services. It is prohibited for a procurement officer to ratify such acts.

(1) Ratification by a Governmental Body. The Office of General Services hereby delegates authority to ratify such acts to the head of the governmental body or his designee above the level of the procurement officer responsible for the person committing the act when the value of the contract is within the dollar limits designated by the Budget and Control Board for that governmental body.

(2) Ratification by the Office of General Services. The Director of the Office of General Services may delegate authority to ratify such acts other than those specified in Item 1 above to the Chief Procurement Officers in such amounts as the Director may determine.

(3) Corrective Action and Liability. In either case referred to in Items 1 and 2 above, the head of the governmental body or his designee as authorized in writing above the level of the procurement officer, shall prepare a written determination as to the facts and circumstances surrounding the act, what corrective action is being taken to prevent reoccurrence, action taken against the individual committing the act, and documentation that the price paid is fair and reasonable.

23 S. C. Code Ann. Regs. 19-445.2015 (Supp. 2009)