

Natomas Unified School District “Right Idea, Wrong Price”

Issue

The Grand Jury became aware that the Natomas Unified School District purchased a piece of land to construct a high school. The Grand Jury did not question the purchase of the land or the location. The Grand Jury did question the purchase price and the underlying assumptions supporting the price.

The Grand Jury asked three questions:

- Did the Natomas Unified School District Board act in a fiscally responsible manner when it agreed to purchase real estate for the construction of a new high school?
- Was there a degree of impropriety between seller and buyer?
- Did the seller and/or his representatives use unethical means to inflate the selling price?

Reasons for the Investigation

The Grand Jury believed that there were several unusual aspects to the purchase of this property by the Natomas Unified School District which merited investigation including the relations between the buyers and the sellers and their representatives and the appraisal on which the purchase was based.

Background

In 2006-2007, the Natomas Unified School District Board began a search for a suitable site on which to build a high school. The Superintendent of the school district directed the Assistant Superintendent to identify a suitable site. A 41 acre parcel was identified north of the Sacramento city limits in an area known as Natomas Basin. The land was owned by West Lakeside LLC and managed by AKT Development. After identifying the

property, the Assistant Superintendent contacted an attorney at a law firm that had previously negotiated real estate transactions for the school district to handle the purchase. The attorney hired an appraiser to value the land.

The property was zoned A1 agricultural and not incorporated into the city of Sacramento or subdivision of Natomas. This land also had a number of environmental issues which included being part of a state flood plain, partially protected under the Endangered Species Act and partially protected under the Williamson Land Act. Testimony before the Grand Jury indicated that the 41 acres had a value as agriculture land of \$50,000 to \$60,000 per acre in 2007 for a total value of approximately \$2,000,000. A senior property appraiser from the State of California Office of Real Estate Appraisers testified and provided documents to support this value.

The 41 acres was originally part of a larger parcel that had already been developed as residential property. The assessed value of the previously developed residential parcel was set by the county assessor at approximately \$272,000 per acre in January 2007. This assessment was based upon the value of developed property for residential use within the City of Sacramento which included all utilities, streets and re-zoning from agricultural to residential.

An appraiser opined that the "fair market value" for this type of fully developed residential land was approximately \$600,000 per acre. At this valuation the total price of the 41 acres would be \$24,600,000. The seller, West Lakeside LLC, used this appraisal to set a price for the sale of the 41 acres at \$650,000 per acre.

However, the 41 acres that Natomas Unified School District was considering purchasing had not been developed, had not been annexed to the City of Sacramento, had not been re-zoned from agricultural to residential and had no utilities or streets. Also portions of the 41 acres were protected under the Endangered Species Act and the Williamson Land Act thus reducing the amount of land available for building.

The attorney negotiated with the seller agent/broker. In negotiations for the sale of the property, the seller agreed to sell the 41 acre parcel at \$325,000 per acre for a total of \$13,325,000. As conditions to the sale and terms of the contract, Natomas Unified School District agreed that it would:

- be solely responsible for providing any habitat mitigation (approximately \$15,000/acre);
- install all offsite roads and utilities required; pay for the cost of improvements (one-time \$450,000);
- pay development fees and bond debt burden (\$39,948/acre);
- maintain a 200 foot agricultural buffer zone on the eastern perimeter of the land which could not be used as part of a building site.

The Natomas Unified School District Board was led to believe that the property would be annexed by the City of Sacramento. The contract was silent as to who would be responsible for paying any costs associated with the annexation.

The \$13,325,000 price was agreed upon by the parties' representatives, and a preliminary contract was drawn and presented to the Superintendent and the School Board. After a brief review of the appraisal and the contract, the Board approved the purchase based upon the appraisal.

During the time that the school district was negotiating for land to build a new school, the Superintendent was actively soliciting donations for the Natomas School Foundation. He had established this foundation and sat on its board. One of the potential contributors that the Superintendent had approached was a partner in West Lakeside LLC and AKT Development. This partner ultimately donated hundreds of thousands of dollars to the Natomas School Foundation.

Since \$13,325,000 was a reduction of 50% from the asking price and with the land being sold to a school district, the seller wanted this amount as a tax consideration and requested documents supporting this claim from the school district.

Methodology

In order to investigate this transaction it was necessary to:

- Identify the process involved.
- Compile a list of persons involved in the sale of the land, the purchase of the land and the overall purchase process.
- Review the appraisal of the land.
- Identify the School Board members and all of the legal and advisory consultants that were part of the entire process including:
 - the school board
 - the school superintendent
 - the assistant school superintendent
 - the attorney hired to handle the transaction on behalf of the school district
 - the appraiser
 - the attorney hired to advise the school board on environmental issues
 - West Lakeside LLC
 - AKT development
 - the attorney hired by the seller to broker the transaction.

Results of the Investigation

The School Board and the Superintendent relied on only one appraisal. Professionals in education administration such as the San Francisco Bay Area California Association of School Business Officials believe that all real estate transactions should have a minimum of three appraisals from disinterested professionals who do not know one another.

The Assistant Superintendent, who was directed to facilitate this transaction, hired an attorney to bring together West Lakeside (the seller) and Natomas Unified School District (the buyer). The Assistant Superintendent allowed the attorney to select and hire an appraiser to determine the market value of the land. Normally the seller or buyer

hires the appraiser. Sworn testimony before the Grand Jury revealed that the Assistant Superintendent and the attorney directed the appraiser as to what assumptions to use in determining the value of the property. The attorney acting for the District was legally bound to keep confidential his conversations with the appraiser. Thus the District's actions which were supposed to be open and transparent were instead protected and made private by the attorney client privilege.

Three months after the close of escrow, the attorney filed a Declaration of Conflict of Interest with the Natomas Unified School District. It was revealed that the attorney's law firm representing the school district had represented the seller, West Lakeside LLC, in the past, and therefore would have a conflict of interest between seller and buyer.

The appraiser's method was not in compliance with accepted standards as required by the Business and Professions Code. The appraisal when first submitted to the School Board for review was lacking complete information. The appraiser testified under oath that he was instructed by the attorney to perform an appraisal based on various assumptions. These assumptions inflated the value of the property. Comparable values were based upon the developed residential property that was adjacent to the 41 agricultural acres which were to be purchased. The appraisal contained errors and omissions including but not limited to:

- incorrect date of appraisal
- no indication that the school district was the purchaser
- incorrect parcel numbers
- incorrect tax rate
- references to buildings that did not exist
- identifying surrounding land as industrial
- implying that the flooding issue had been fully resolved
- lack of development impediments that exist due to endangered species protection
- failure to adequately discuss existing legal constraints under county jurisdiction
- indication that all utilities are available
- no mention of a wetlands issue

The misleading appraisal was attached to the contract that was accepted by the School Board and the Superintendent. The acceptance of this purchase was the responsibility of the school board and the Superintendent. After the contract was approved by the board based upon the misleading appraisal, the appraiser prepared a second appraisal which dealt with some of the earlier omissions and areas of concern. Most of the Board never looked at the second appraisal.

Findings and Recommendations

Finding 1 – The Natomas Unified School District Board and Superintendent did not exercise proper oversight of the land acquisition process. Their lack of due diligence reflects an abdication rather than a delegation of oversight responsibilities.

Recommendation 1.1– The California School Board Association should be invited to conduct training in land acquisition for both the Natomas Unified School District Board and Superintendent.

Recommendation 1.2 – The Natomas Unified School District Board should demand more direct involvement of the Superintendent in major financial transactions, and he should be held personally accountable for the outcome of those transactions.

Finding 2 – Obtaining a single appraisal under the protection of attorney client privilege does not allow for full disclosure and transparency of the purchasing process. The appraiser hired and directed by the attorney was provided information based on erroneous facts which were incorporated into the appraisal that was submitted to the Natomas Unified School Board.

Recommendation 2.1 – The School District and Superintendent should always have direct control over the hiring of any appraiser.

Recommendation 2.1 - In addition, a minimum of three independent appraisals should be required for any subsequent land purchase.

Finding 3 – The Superintendent’s solicitation of a contribution from a related party to West Lakeside LLC, for a foundation on whose board the Superintendent sat, during the

course of purchasing negotiations, reflects poor judgment. The solicitation lays open the appearance of a “quid pro quo” agreement for purchase of the Natomas land site at an inflated price.

Recommendation 3 - The Superintendent should be sanctioned by the Natomas Unified School District Board for carrying out such an ill timed solicitation.

Finding 4 – The attorney retained by the School Board failed in his fiduciary responsibility to make the Natomas School District and Superintendent aware of his past dealings with West Lakeside LLC and AKT Development and the conflict of interest.

Recommendation 4 – A complaint should be filed with the California State Bar by the Natomas Unified School District Board against the attorney and his law firm.

Finding 5 –The Assistant Superintendent and the School District’s attorney were involved in instructing the appraiser as to the assumptions that he should use. The appraisal contained false and misleading assumptions which greatly inflated the sales price paid by the Natomas Unified School District. Standard appraisal practices were not followed. The appraiser failed to recognize his obligations to maintain his objectivity and independence.

Recommendation 5 – This matter should be referred to the Sacramento District Attorneys Office and the State Attorney General as well as any other governmental agency for any further investigation they deem appropriate.