



TN

TDOT

Department of
Transportation

Follow-Up Audit of the Right-of-Way Division's Property Acquisition Process

Tennessee Department of Transportation - Division of Internal Audit
Government Accountability Professionals

Final Report | July 2017

The mission of the Division of Internal Audit is to provide objective analysis and information critical to better decision making and enhancing the overall governance capability within the Tennessee Department of Transportation.



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Results in Brief

We conducted a follow-up performance audit of the Right-of-Way Division's (ROW) property acquisition processes covering the period January 1, 2013 through December 31, 2015. The audit results indicated that, for the transactions tested, the ROW management has discontinued the use of consultant escrow accounts for property acquisitions. However, ensuring proof of property acquisition such as deeds and judgments would benefit from additional controls and ensure compliance with existing policy. Audit objective questions and conclusions included ascertaining the following:

- ***Since the last audit, has the ROW Division discontinued the use of consultant escrow accounts for property acquisitions?***

Yes. Internal controls were in place and working as intended. We did not observe the use of consultant escrow accounts for purchase of right-of-way property in our testing for the audit period.



Internal Control Evaluation: Managed

- ***Were internal controls in place to ensure that proof of ownership was received after vouchers were issued for purchase of property?***

Generally Yes. Current practices and procedures result in Warranty Deeds being available in the ROW Division. However, the completeness of headquarters' files will benefit from process improvements and monitoring compliance with existing ROW policy.



Internal Control Evaluation: Managed

Key Recommendations

- The headquarters' ROW Division should manage the official records to ensure that they receive proof of ownership for the acquisition of property.

Introduction

Audit Initiation

We conducted a follow-up audit to the *Acquisition and Property Management Process at the Regional Right-of-Way Offices (2012)* in fulfillment of the annual audit plan for the fiscal year 2016, as presented to the Commissioner of Transportation, the Deputy Commissioner of Transportation, and the Comptroller of the Treasury.

The overarching goal of every performance audit engagement conducted by the Division of Internal Audit (IA) is to assist those charged with governance by providing information to help improve operational performance, reduce costs, facilitate decision-making, and contribute to public accountability.

Background

The ROW Division is one of 30 divisions within the Tennessee Department of Transportation (TDOT) and is responsible for the appraisal and acquisition of land needed for highway construction projects. This division also manages the relocation of displaced families and businesses, disposal of excess land, and utility relocations connected with right-of-way acquisitions.

Headquarters (HQ) is responsible for coordinating all phases of right-of-way, for establishing the policies and operating procedures of the division, and for monitoring field office operations. Additionally, headquarters is directly responsible for contracting out property appraisals, fee appraisal reviews, acquisition services, relocation services, and related functions as necessary. Headquarters is also directly responsible for right-of-way acquisition from railroads and from federal or state agencies and local governments.

The field offices are the operational arms of the division. The regional personnel are directly responsible for the multiple operational functions of acquiring real property required for state transportation needs. In all acquisitions, both state and federally funded, the department adheres to provisions of the Uniform Relocation Assistance and Real Property Acquisition Policies Act.

The ROW Division at TDOT headquarters sets policies and procedures, as well as monitor regional operations, but does not have direct supervision over the regional right-of-way activities.

Operational and Financial Information

Right-of-way operations implemented a custom, web-based application in 2015, the Integrated ROW Information System (IRIS). IRIS provides a platform to standardize the acquisition activities across different TDOT divisions, consultants, and property acquisition teams. It is also used to track the right-of-way acquisition process beginning with the initial tract selection, title search, appraisal, offer to acquire, closing and potential condemnation proceedings, demolition, and property management. This application is being adopted by regional operations.

Financial Information

The ROW budget for each project is contained within the overall budget for that project, and the acquisition budget is based on preliminary appraisals. Actual annual expenditures depend both on the projects that are underway, and the current appraised/purchase value.

TDOT purchase of ROW property varied between \$36 million and \$54 million annually during the audit period, with a total of \$127 million spent during the three year audit period on 443 separate projects. ROW expenses for each property tract acquired include such expenditures as appraisals, title searches, market data research, and purchase of property, relocation assistance payments, legal fees, and consultant fees.

Exhibit A – Right-of-Way Expenditures by Account Description

| Account Description | 2013 | 2014 | 2015 | Total |
|-------------------------------------|----------------------|----------------------|----------------------|-----------------------|
| Purchase of Land Right-of-Way | \$ 11,999,554 | \$ 31,579,018 | \$ 18,559,589 | \$ 62,138,161 |
| Court Deposits and Payments | 19,106,524 | 14,697,244 | 11,135,387 | \$ 44,939,155 |
| Other Payments to Property Owners | 3,336,547 | 3,895,917 | 3,928,899 | \$ 11,161,363 |
| Consulting Services-ROW | 2,705,309 | 3,598,235 | 2,365,640 | \$ 8,669,184 |
| Closing Agents, Title Co. Appraisal | 173,306 | 249,848 | 138,579 | \$ 561,733 |
| Other Legal Services | 42,849 | 28,997 | 33,923 | \$ 105,769 |
| Land | - | 3,618 | - | \$ 3,618 |
| Total | \$ 37,364,089 | \$ 54,052,877 | \$ 36,162,017 | \$ 127,578,983 |

Source: Financial Information from Edison as provided by Finance

Exhibit B – Right-of-Way Expenditures by Region

| Year | 2013 | 2014 | 2015 | Total |
|-----------------------|----------------------|----------------------|----------------------|-----------------------|
| Region 1- Knoxville | \$ 7,127,151 | \$ 17,226,577 | \$ 13,619,360 | \$ 37,973,088 |
| Region 2- Chattanooga | 5,339,367 | 16,215,685 | 10,959,066 | \$ 32,514,118 |
| Region 3- Nashville | 17,137,010 | 15,932,558 | 9,335,326 | \$ 42,404,894 |
| Region 4- Jackson | 7,754,014 | 4,676,908 | 2,248,264 | \$ 14,679,186 |
| Other | 6,548 | 1,150 | - | \$ 7,698 |
| Total | \$ 37,364,090 | \$ 54,052,878 | \$ 36,162,016 | \$ 127,578,984 |

Source: Financial information from Edison as provided by Finance

The Federal Highway Administration (FHWA) administers the federal money available to TDOT, based on federal gasoline taxes of 18.4 cents per gallon and federal diesel taxes of 24.4 cents per gallon. The FHWA reimburses TDOT for actual expenditures, up to a set limit, for work on pre-approved projects, including expenses for design, right-of-way, and construction for roads, bridges, and tunnels. The reimbursement percentage can vary, but it is typically set at 80 percent of actual expenditures, payable upon request by the TDOT Finance Division. During the audit period, the FHWA reimbursed approximately \$123 million to TDOT for ROW acquisitions.

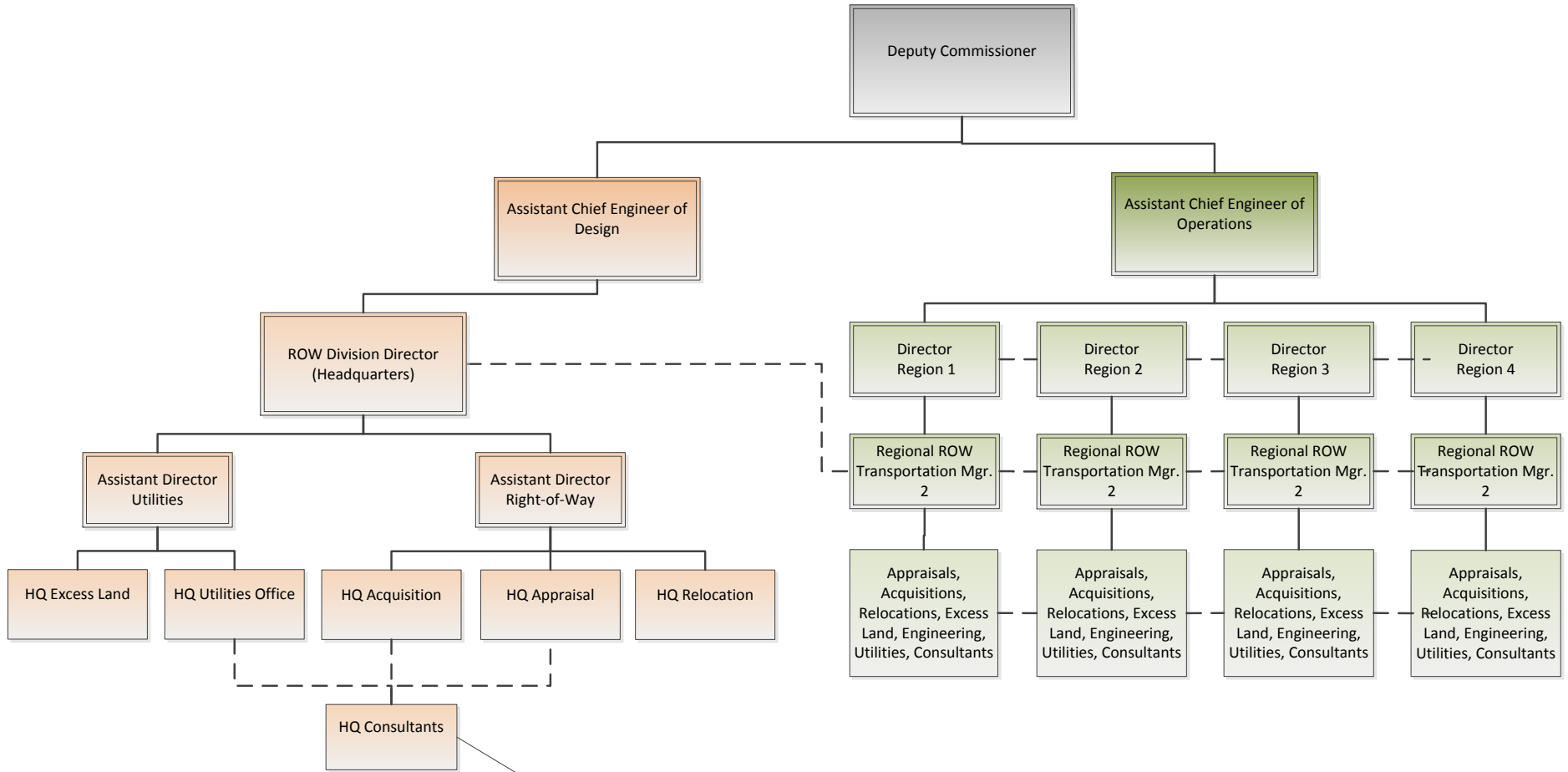
State fuel taxes fund the state portion of construction expenditures and all road maintenance activities. The Tennessee gasoline tax is 21.4 cents per gallon and the diesel tax is 18.4 cents per gallon. The Tennessee Department of Revenue collects and allocates the gasoline tax monies to TDOT on a quarterly basis.

Background and Process Flow

The ROW acquisition process begins when a project is authorized to proceed. Program Operations, part of the Program Development and Administration Division, receives a request to obtain confirmation of the availability of funding from the FHWA. The FHWA will authorize funding for a specific function, i.e. appraisals only, appraisals and acquisitions, etc. Once the FHWA authorizes funding, the ROW Division proceeds with acquisition. The process of acquiring right-of-way includes the following:

- Headquarters contracts for current independent, outside appraisals of property and provides these appraisals to the appropriate region
- Regional appraisal staff review and approve the outside appraisals
- Regional staff contact the landowner and present an offer for the appraised value of property
- If the property owner accepts TDOT's offer, the region's engineering office checks all title reports for compliance with roadway plans, makes plan revisions as appropriate, and provides technical assistance
- The regional staff is responsible for the closing activities and obtaining the registered Warranty Deed. Outside consultants may be employed to assist with closing activities
- If closed by a consultant, the original recorded Warranty Deed is sent to the region for filing
- If TDOT does not accept the owner's counteroffer, the region sends the property to the Attorney General's office for condemnation proceedings
- After the condemnation is settled, the Attorney General sends the original final judgment to the regions to be registered with the county deeds office
- The regional ROW sends the deed or judgment to headquarters so the legal description can be checked against the plans and, if the regions haven't, headquarters scans and uploads the documents into IRIS

Exhibit C – Organizational Chart



Consultant responsibilities are spread across the functional areas (i.e. utility coordination contracts fall under the Assistant Director-Utilities, while appraisal and acquisition contracts are the responsibility of Assistant Director- ROW).

Audit Overview

The aim of the *Follow-up Audit of the Right-of-Way Division* engagement was to verify that consultant escrow accounts were no longer in use (in conjunction with acquisition of property), thereby eliminating the risks associated with the business practice. Our initial audit of the ROW property acquisition process uncovered instances of consultant's breach of fiduciary duties through escrow accounts and a lapping scheme to facilitate financial fraud against TDOT. Our recommendation was for management to discontinue the use of escrow accounts when utilizing consultant services. In addition, we also wanted to ensure that ROW had proof of ownership for acquired property.

We utilized a risk management based methodology to provide an assessment of (a) general accounting controls, (b) transparency and accuracy of transactions, and (c) compliance with policies and statutes. Our audit activities also delved into areas of process improvements that will enable the efficient use of limited resources and enhance the effectiveness of service delivery.

The audit scope covered the transactions, balances, procedures, and policies in effect for the period January 1 2013 through December 31, 2015. During the period under review, we relied on:

- ROW Procedures Manual
- Interviews and information provided by regional operations
- Interviews and information provided by ROW management
- Quantitative information provided by the Finance Division
- Query outputs from Edison
- Voucher documentation contained in Edison

Audit activities focused on efficient use of resources, heightened internal controls over consultant services, and effectiveness of service delivery.

Objectives and Conclusions

1. Since the last audit, has the ROW Division discontinued the use of consultant escrow accounts for property acquisitions?

Yes. Results of the test work performed returned no instances of consultant escrow accounts being used in conjunction with acquisition of right-of-way property. A review of supporting documentation in the test sample indicated that all vouchers were in payment of appraisal services, market data brochures, legal advice and testimony, or other miscellaneous tract related services.

We obtained a list of payments made for all ROW activities during 2013, 2014, and 2015 for seven Edison account codes identified by the TDOT Finance Division as financial transactions attributable to ROW property acquisition operations. We used information from these account codes to conduct our testing of right-of-way transactions including the following:

- Purchase of Land Right-of-Way
- Court Deposits and Payments
- Other Payments to Property Owners
- Consulting Services - ROW
- Closing Agents, Title Co., Appraisal
- Other Legal Services

To identify potential use of consultant escrow accounts, we first sampled transactions for which ROW issued *Consulting Services* vouchers. We isolated 167 vouchers totaling \$668,347, we identified as unique payments to consultants unrelated to purchase of land or court deposits and payments. These transactions should contain any accounting anomalies and potential payments to consultants (for land acquisition). Subsequently, we examined supporting documentation required prior to issuance of the voucher to ascertain its purpose. Using this methodology, we did not observe any vouchers containing an *Agreement of Sale* or any other voucher support documentation indicating that the voucher was issued for the purchase of property.

In testing for the existence of escrow accounts, we requested a list of all consultants used for closing activities during the audit period from both the regional ROW managers and the headquarters ROW management. We received a list of 18 consultants with transactions during the audit period totaling \$2,031,094. We tested transactions totaling 1,290,818 for 15 closing consultants. We examined supporting documentation for each voucher to ascertain the justification for the transactions. We did not observe vouchers

containing an *Agreement of Sale* or other documentation indicating that the voucher was issued in payment for purchase of property or deposits to an escrow account.

Exhibit D - Results of Consultant Escrow Account Testing

| | Number of Vouchers Tested | Monetary Amount of Vouchers Tested | Vouchers for Purchase of Property |
|---|---------------------------|------------------------------------|-----------------------------------|
| Vouchers issued for "Consulting Services ROW" without a separate payment for purchase of property | 167 | \$ 668,347 | - |
| Vouchers issued to Closing Consultants used during the audit period | 87 | \$ 281,933 | - |

Source: Internal Audit Test Work

2. Were controls in place to ensure that TDOT received proof of ownership for all tracts for which a voucher was issued?

Generally Yes. To complete this objective, we selected a judgmental sample of transactions from the account codes *Purchase of Land Right-of-Way, Court Deposits and Payments, Land, and Other Payments to Property Owners*. We conducted a test of Warranty Deeds and Judgments to determine whether proof of ownership was received for acquisition of property. The ROW *Policies and Procedures Manual* indicated that one copy of all documents pertinent to the project or to individual tracts on the project be transferred to the official file immediately.

A Warranty Deed normally records the transfer of legal ownership when there is an agreement of sale between the landowner (seller) and TDOT (buyer) for an agreed-upon price. A judgment¹ is a court order mandating the transfer of ownership from the landowner to TDOT at a court-determined price.

¹Note: The term *Judgment* used in this context is a generic representation of the terminology used by the various judicial districts in Tennessee for the assignation of ownership in condemnation cases. The various legal terminology used includes, but is not limited to, *Judgment and Final Decree, Consent Judgment and Final Decree, Agreed Final Order, Final Decree, and Default Judgment and Final Order*.

During the test work, we observed that 20 percent of the transactions tested did not require a Warranty Deed or Judgment at the time of testing. These transactions consist of condemnations (which are still active in the judicial process) and inverse condemnations wherein a property owner has sued TDOT for either damages caused to non-ROW property, payment for easements², or similar transactions. Eighty percent of tract files contained Warranty Deeds or Judgments.

We obtained information for all vouchers from Edison account codes *Purchase of Land Right-of-Way, Court Deposits and Payments, Land, and Other Payments to Property Owners*, totaling \$118,242,297. These ROW codes represent payment for purchase of property for ROW and could include payments for other ROW activities. We selected a judgmental sample of 215 transactions from these account codes, totaling \$38,410,605. We determined the purpose for the voucher by examining the voucher supporting documents. Vouchers supported by a signed *Agreement of Sale* or correspondence stating that the property tract had been sent to the Attorney General's office for condemnation proceedings were deemed to require either a Warranty Deed or Judgment showing proof of ownership. In addition, we tested payments made for residential or non-residential relocation of the property owners. While not a direct payment for purchase of property, these payments indicate that the property is in the process of being acquired or has been acquired.

Exhibit E - Results of Deeds Testing

| | Purchase of Land | Court Deposits | Land and Other Payments | Total |
|---|------------------|----------------|-------------------------|---------------|
| Deeds/Judgments Foundⁱ | \$ 13,393,688 | \$ 8,851,545 | \$ 3,913,768 | \$ 26,159,001 |
| Easementsⁱⁱ | 62,835 | - | - | \$ 62,835 |
| Open Condemnationⁱⁱⁱ | 117,000 | 11,357,338 | - | \$ 11,474,338 |
| Closed Condemnation^{iv} | 117,840 | - | - | \$ 117,840 |
| Inverse Condemnation^v | - | 563,700 | - | \$ 563,700 |
| Payment for Damages^{vi} | 3,756 | - | - | \$ 3,756 |
| Tracts Not Finalized^{vii} | - | - | 29,135 | \$ 29,135 |
| Total Transactions Tested | \$ 13,695,119 | \$ 20,772,583 | \$ 3,942,903 | \$ 38,410,605 |

Source: Internal Audit Test Work

²The seven transactions reflecting payments for easements in our data contained registered easements in the tract files.

Exhibit F – Results of Deeds Testing

| Transaction Description | Purchase of Land | Court Deposits | Land and Other Payments | Total |
|----------------------------------|------------------|----------------|-------------------------|------------|
| Deeds/Judgments Found | 65 | 40 | 68 | 173 |
| Easements | 7 | - | - | 7 |
| Open Condemnation | 1 | 28 | - | 29 |
| Closed Condemnation | 1 | - | - | 1 |
| Inverse Condemnation | - | 2 | - | 2 |
| Payment for Damages | 1 | - | - | 1 |
| Tracts Not Finalized | - | - | 2 | 2 |
| Total Transactions Tested | 75 | 70 | 70 | 215 |

Source: Internal Audit Test Work

Compliance with Existing Standards

The ROW Division provided us with their *Right-of-Way Policies and Procedures Manual* containing the policies, procedures, and practices to be followed in carrying out all major functions performed by the division. The manual states that each field office is responsible for maintaining an official records system. All documents pertinent to the project or to individual tracts on the project must be incorporated into the official files. The files are to be made available for inspection at reasonable times by authorized state or federal representatives. Statements by headquarters ROW personnel indicated that headquarters does not track closings to determine whether deeds have been received by TDOT; that is the responsibility of the regional ROW personnel.

Observations and Recommendations

A – Headquarters ROW Division does not have internal controls to ensure that TDOT receives proof of ownership for right-of-way acquisitions.

Tract files are created when information is received from the regions, and the original Warranty Deed or Judgment is filed when it is received from the region. Headquarters does not track what deeds and judgments are outstanding and which have been received by headquarters. Regions are responsible for tracking acquisition of required projects and sending the original Warranty Deed or Judgment to headquarters when received.

The results of this work indicated that ROW property acquisition activities needs to adhere to existing controls to ensure that deeds and judgments are obtained for all properties for which payment has been made.

Principle 10.03 of the *Green Book*³ states that management compares actual performance to planned or expected results throughout the organization and analyzes significant differences.

Criteria:

- Green Book Principle 10 – Design Control Activities
- Committee on Sponsoring Organizations of the Treadway Commission (COSO) Internal Control - Integrated Framework
- Prudent business practices

Risks or Effects:

- TDOT has expended money for purchase of right-of-ways where proof of ownership is not conveyed

Headquarters ROW does not track the original deeds and judgments received at headquarters

³The *Green Book* provides managers criteria for designing, implementing, and operating an effective internal control system.

Recommendation(s):

A.1 – The ROW Division management should track all proof of property acquisitions from regional ROW transactions. Tracking of deeds and judgments received at headquarters would provide a control system that ensures all deeds and judgments are obtained and recorded appropriately. It is the responsibility of the regional operations to obtain and register ROW deeds for all necessary tracts; however, ROW headquarters' management is responsible for monitoring field office operations.

A.2 – The ROW Division management should generate a report at headquarters using IRIS and reconcile this report to the regional report, Form 10⁴, to verify proof of ownership for the acquisition of property had been received.

⁴Form 10 is a project summary that the regions provide to headquarters. The summary states how many tracts a project has and the status of each tract, i.e., still in negotiations, having a deed, or judgment.

General Audit Information

Statement on Compliance with GAGAS

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the work to obtain sufficient, appropriate evidence to provide a reasonable basis for our observations and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our observations based on our audit objectives.

Scope and Methodology

The audit period focused primarily on right-of-way acquisition by the headquarters ROW Division and the regional right-of-way operations covering the period January 1, 2013 through December 31, 2015. The methodology employed throughout this audit was one of objectively reviewing and evaluating various forms of documentation including accounting and financial information, written policies and procedures, contracts, and data in various forms, as well as performing test of details, analysis, and benchmarking.

Criteria

In conducting the audit, we evaluated ROW against existing State of Tennessee statutes, and internal policies applicable to the function of the ROW Division. We also utilized other standards such as COSO Internal Control-Integrated Framework and Green Book. We also used industry and other business norms as supplementary criteria, especially as they pertained to internal controls and prudent business practices, to complete the objectives of this engagement.

Staff Acknowledgment

Alisa Brock – Internal Auditor In-Charge

Nichole Sly – Staff Internal Auditor

Roger Miller, CPA – Quality Assurance

Mel Marcella, CPA, CMA, CIA, CISA, CFE – Quality Assurance

Appendix A – Management Responses

Acknowledgment Letter and Response Matrix In the Following Pages



**STATE OF TENNESSEE
DEPARTMENT OF TRANSPORTATION**

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JOHN C. SCHROER
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BILL HASLAM
GOVERNOR

July 20, 2017

Mel Marcella
Director of Internal Audit
James K. Polk Building, Suite 1800
Nashville, TN 37243

Dear Mr. Marcella:

This letter acknowledges that the Right-of-Way Division is in receipt of the report titled *Follow-Up Performance Audit of the Division of Right-of-Way Property Acquisition*, which was conducted by the Division of Internal Audit.

We have reviewed the audit report and evaluated all the observations raised in this report. The Right-of-Way Division will undertake the recommended actions. Attached please find our formal responses to the recommendations and the proposed plan of action. This audit will serve as a valuable instrument and management tool in helping the Tennessee Department of Transportation meet its objectives and goals.

Sincerely,

A handwritten signature in blue ink, appearing to read "Jeff Hoge".

Jeff Hoge, Director
Right of Way Division

**Right-of-Way Division
Management Responses to Audit Recommendations – June 2017**

| Report Item and Description | Responses to Recommendations/Action Plan | Assigned Responsibility | Estimated Completion |
|---|---|---|---|
| <p>A.1 – The ROW Division management should track all proof of property acquisitions from regional ROW transactions. Tracking of deeds and judgments received at headquarters would provide a control system that ensures all deeds and judgments are obtained and recorded appropriately. It is the responsibility of the regional operations to obtain and register ROW deeds for all necessary tracts; however, ROW headquarters' management is responsible for monitoring field office operations.</p> | <p>Accept All regional right of way staff have been informed of importance of uploading conveyance documents to IRIS. HQ staff will develop procedures to monitor project status. Varying approaches will be required as we exhaust the backlog of projects that predate IRIS.</p> | <p>HQ Assistant ROW Director and supporting acquisition staff</p> | <p>Immediate implementation of document review with fully developed procedures expected within 1 year</p> |
| <p>A.2 – The ROW Division management should generate a report at headquarters using IRIS and reconcile this report to the regional report, Form 10, to verify proof of ownership for the acquisition of property had been received.</p> | <p>Accept HQ Right of Way will reconcile regional reporting (via Form 10) to verify that all available parcels reported have proof of ownership/availability prior to certification of the project. Regional project development directors and right of managers will be notified of their responsibility to ensure that IRIS is adequately documented so that all pertinent dates and executed documents are available for review within the project schedule. HQ Right of Way will develop a report that will document the reconciliation process.</p> | <p>HQ Assistant ROW Director and supporting acquisition staff</p> | <p>Immediate implementation of document review with fully developed procedures expected within 1 year</p> |

Appendix B – References

Government Accountability Office. (2014). *Standards for Internal Control in the Federal Government*. Washington, DC: U.S. Government Printing Office.

ROW Audit Final Report . (2012). *Audit of the Acquisition and Property Management Process at the Regional Right of Way Offices*. Retrieved from http://www.tn.gov/assets/entities/tdot/attachments/Right_of_Way_-_December_2012.pdf

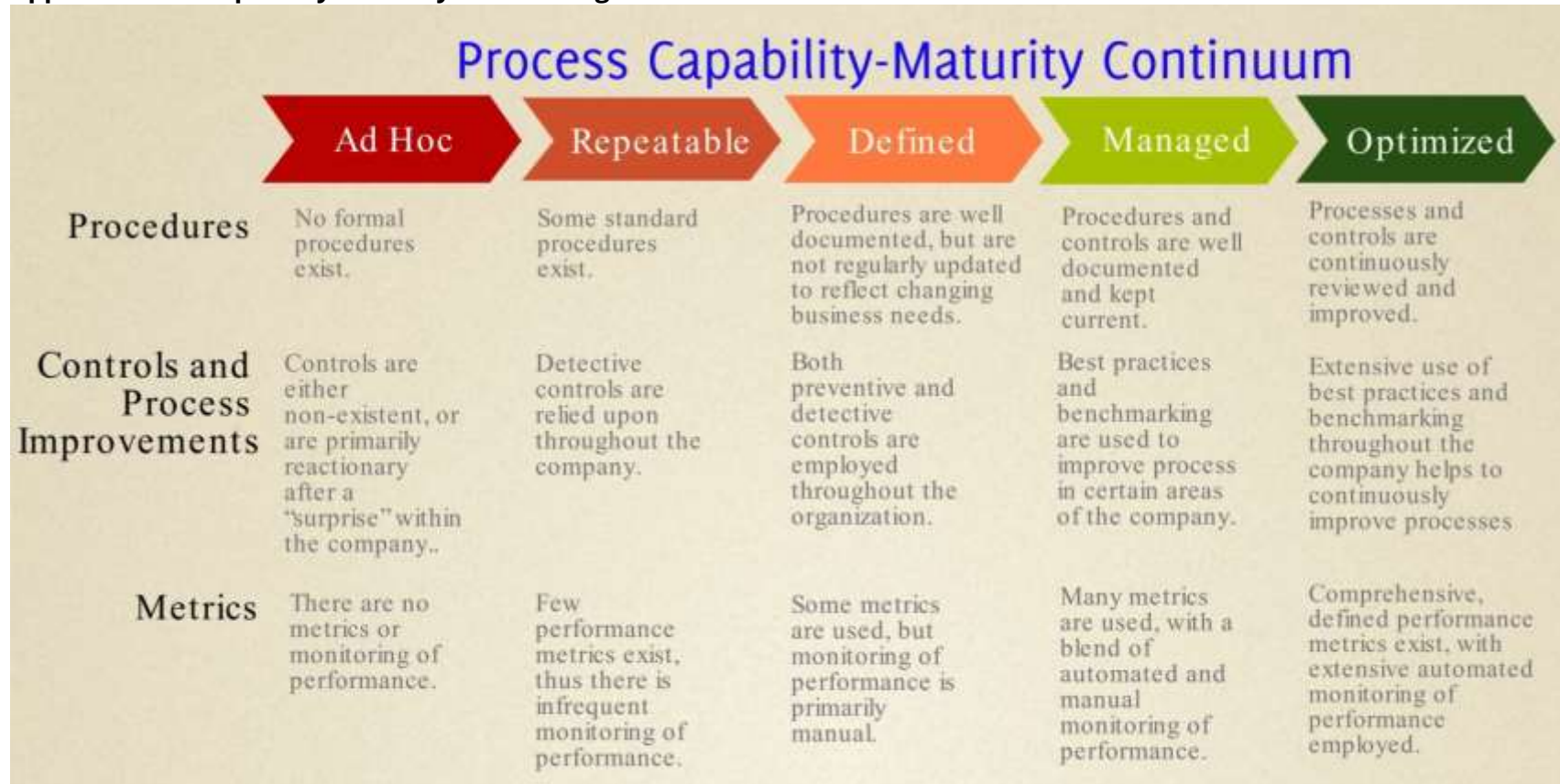
ROW Manual. (2010). *Tennessee Department of Transportation Right-Of-Way Division*. (TDOT Publication). Nashville, TN.

Tennessee Department of Transportation. (2017). *Nationwide Gas Tax Ranking*. Retrieved from <https://www.tn.gov/tdot/article/gas-tax-ranking/>

The Committee of Sponsoring Organizations of the Treadway Commission COSO. (2013). *Internal Control Framework*. Retrieved from <https://www.coso.org/Pages/default.aspx>

Appendix C – Tables and Charts

Appendix C.1 – Capability Maturity Model Integration



Source: Carnegie Mellon University

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- ⁱ When transferring ownership between two parties, a legal document in the form of a deed is issued.**
 - ⁱⁱ Easements do not transfer ownership rights, and therefore a deed is not issued. Easements allow TDOT to have access to property for a specified period of time.**
 - ⁱⁱⁱ In an open condemnation, TDOT has made the initial deposit of the appraised value with the appropriate court. However, a judgment which awards ownership to the State of Tennessee will not be issued until the condemnation is closed.**
 - ^{iv} When a condemnation is closed, the judicial process is complete and a judgment is issued.**
 - ^v Inverse condemnation occurs when a property owner sues TDOT for damages caused to their property. An award to the property owner does not transfer ownership.**
 - ^{vi} Payments for damages do not transfer ownership rights.**
 - ^{vii} Tracts that are not finalized or still in negotiation will not contain a deed until complete.**