



TORONTO STAFF REPORT

July 8, 2006

To: Audit Committee

From: Auditor General

Subject: Review of the Administration of Leases on City-owned Property

Purpose:

This report provides the results of the Auditor General's review of the Administration of Leases on City-owned Property. This review was conducted as part of the Auditor General's 2006 Annual Work Plan.

Financial Implications and Impact Statement:

The implementation of certain recommendations in this report will improve management of the City's leasing operations and likely generate additional rental revenue, the exact amount of which cannot be determined at this time. The implementation of other recommendations in this report may require additional resources. The extent of any resources required is not determinable at the present time.

Recommendations:

It is recommended that:

(1) the following recommendations in the attached Auditor General's report entitled "Review of the Administration of Leases on City-owned Property" be adopted:

- "1. The City Manager ensure that a centralized inventory of leases for City-owned property is prepared and that all lease information included in this inventory is accurate and complete. The inventory should include information relating to rental amounts, lease expiry dates, details of the property being leased and details relating to the tenant. Information contained in the inventory of City property and maintained by the Facilities and Real Estate Division should be reconciled to the inventory of property leases. Any items which do not reconcile should be reviewed and appropriate action taken.

2. The City Manager, at the conclusion of the review of the governance structure relating to the City's property maintenance program, give consideration to how the recommendations resulting from the governance review may have relevance to the management of the City's lease portfolio.
3. The City Manager, in consultation with the appropriate General Managers, ensure that all leases contained in the final inventory listings are clearly assigned to appropriate Divisional staff. Staff be advised of such assignments and be held accountable for the efficient and effective management of all leases within their portfolio.
4. The Deputy City Manager and Chief Financial Officer take steps to ensure that accurate and complete revenue and cost information for each leased property is accounted for in the SAP Financial Information System by requiring that:
 - (a) separate cost centres are maintained in the SAP Financial Information System for each leased property and all property revenue and expenditures are charged to separate property cost centres;
 - (b) financial reports for individual leased properties are prepared, reviewed and approved by senior staff. Financial results which are unexpected and unusual be identified and appropriate action taken; and
 - (c) the financial performance of properties be reviewed and evaluated prior to the negotiation of lease agreements. Evidence of such review be contained in all leasing files.
5. The City Manager take appropriate steps to implement the lease management function of the SAP Real Estate Module for all City leases, including those administered by the Parks, Forestry and Recreation Division. Unless there are compelling reasons to the contrary, the future development of alternative management information systems be discontinued.
6. The City Manager take steps to:
 - (a) review the status of all City lease agreements in order to ensure that every agreement is current. Immediate action be taken to finalize all expired leases; and
 - (b) ensure that the SAP property management module currently being developed includes a facility to identify lease expiry dates well in advance of the actual expiry date so that expiring leases are identified and renewed on a timely basis.

7. The City Manager direct that a complete review of all lease agreements be initiated in order to ensure that all tenants are paying rent in accordance with specific provisions in lease agreements. Where lease payments are less than contractual amounts, efforts be made, in consultation with City Legal, to recover underpayments. A formal ongoing reporting process be established to ensure that appropriate lease payments are made on a timely basis.
8. The City Manager, in consultation with City Legal, direct that a policies and procedures manual for the administration of the leasing of all City-owned property be developed.
9. The City Manager:
 - (a) establish a formal lease compliance program in order to ensure that tenants are in compliance with key operational provisions contained within lease agreements; and
 - (b) occurrences of non-compliance identified during property inspections be followed up on a timely basis and appropriately documented.
10. The City Manager ensure that up-to-date and adequate insurance coverage for all properties leased by the City is obtained. Evidence of insurance coverage be included in all lease files.
11. The City Manager ensure that, wherever possible, lease amounts are established through an independent valuation process such as the use of an appraisal process or through competitive bids. Evidence of such a process be documented and retained in lease files.
12. The City Manager ensure that all vacant City properties available for lease are identified. A proactive process be initiated to ensure that all such properties are marketed on a timely basis.
13. The City Manager review the capacity of current in-house leasing staff to deliver an effective leasing program, and based on this review assess whether there is a financial and operational advantage to assigning the administration of the leasing of City-owned property in whole or in part to an outside property management company. Detailed cost benefit analyses be an integral part of this evaluation.
14. The City Manager ensure that:
 - (a) the inventory of below-market rent leases for City-owned properties is a accurate, up-to-date and complete; and
 - (b) the below-market rent policy addresses tenants who receive below-market rent for land or who have purchase of service agreements with the City.

15. The City Manager ensure that:
 - (a) a detailed financial assessment is conducted for all organizations being considered for below-market rent; and
 - (b) the amount of any rent subsidy provided to organizations be based on the financial capacity of organizations to pay rent.
16. The City Manager review the City's eligibility criteria for the below-market rent policy with a view to making them more specific and measurable.
17. The City Manager establish priorities for providing below-market rent space. The City should allocate below-market space to organizations providing services which will most benefit its residents.
18. The City Manager ensure that:
 - (a) Council reports seeking approval or renewal for leasing space at rates below-market contain the opportunity cost of providing the below-market space; and
 - (b) the accounting of all grants in-kind be incorporated into the Corporate Grants Management Information System currently being developed for all City grants.
19. The City Manager ensure that eligibility reviews conducted for below-market tenants include, where practical, a site visit and a review of other required documentation such as the lease agreement and financial statements. Evidence of completion of the eligibility review, including copies of documentation, should be retained in the lease file.
20. The Deputy City Manager and Chief Financial Officer upgrade the SAP financial information system to automatically produce standard collection reminder letters as soon as possible. When this functionality is implemented, all City Divisions responsible for the billing and collection of accounts receivable be required to use it to create timely reminder notices for all overdue accounts and such notices be sent out on a regular basis.
21. The Deputy City Manager and Chief Financial Officer, in consultation with City Legal, require that all new tenants be mandated to participate in the pre-authorized payment program or provide post dated cheques or rental deposits in advance as a means of collecting rental income on a timely basis.

22. The Deputy City Manager and Chief Financial Officer ensure that:
 - (a) all revenue from existing leases containing provisions for “additional rent” are reviewed to ensure that all rental income is accounted for correctly;
 - (b) all revenue from future leases, including “additional rent”, is accounted for appropriately and recorded as revenue and accounts receivable in the SAP Financial Information System when earned; and
 - (c) all write-offs of outstanding receivables greater than \$10,000, irrespective of whether or not they have been accounted for in the City’s records, be approved by City Council.
 23. The City Manager, in consultation with City Legal, clarify the legal concerns pertaining to the imposition of late payment charges on outstanding accounts and where possible such charges be imposed as soon as possible.
 24. The City Manager ensure that prior to renewing any lease agreement direction be sought from City Legal in order to ensure that there is compliance with any lease renewal provisions and in addition all outstanding receivables are collected prior to the commencement of negotiation of any lease renewal.
 25. City Council direct that this report be forwarded to the City’s major Agencies, Boards and Commissions in order to ensure that concerns, issues and recommendations raised in this report are considered and addressed where appropriate.”
- (2) the City Manager be requested to report to the Audit Committee by June 30, 2007 on the implementation of the recommendations in the Auditor General’s report entitled “Review of the Administration of Leases on City-owned Property”.

Background:

The Review of the Administration of Leases on City-owned Property was conducted as part of the Auditor General's 2006 Annual Work Plan and was conducted in accordance with generally accepted government auditing standards.

Comments:

The attached Auditor General's report entitled "Review of the Administration of Leases on City-owned Property" contains 25 recommendations. Management's response to each of the recommendations contained in this report is attached as Appendix 2.

Conclusions:

The objective of this audit was to assess whether leased City-owned property was being managed to maximize rental income, or other benefits to the City, in compliance with appropriate policies and legislative requirements. Our review identified a number of areas requiring improvement in the City's leasing operations relating to lease and financial information, the management of lease agreements, the below market policy and the billing and collection of rental income.

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List of Attachments:

Appendix 1: Review of the Administration of Leases on City-owned Property

Appendix 2: Management Response to the Auditor General's Review of the Administration of Leases on City-owned Property

**Review of the Administration of Leases on City-owned
Property**

July 8, 2006

 **TORONTO** Auditor General

Review of the Administration of Leases on City-owned Property

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City of Toronto

July 8, 2006

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AUDIT REPORT IN BRIEF

In accordance with the Auditor General's 2006 Work Plan, we have completed our review of the administration of leases on City-owned property. This is the first review by the Auditor General on this particular program since amalgamation.

The majority of lease agreements are managed by the Facilities and Real Estate Division and the Parks, Forestry and Recreation Division. Consequently, our review focused on these two Divisions.

This report contains twenty-five recommendations. The implementation of these recommendations will, in our view, improve the administration of the City's property leasing program and address management control concerns identified during this review.

This report raises fundamental concerns in how the City manages its significant rental property portfolio. Improvements are required in how the City manages its leasing agreements as well as how the City collects its rental income. Based on our review of a relatively small number of lease agreements, it is our view that management internal controls are lacking in certain areas. An absence of such controls has resulted in the City not receiving all of the income to which it is entitled. Due to the fact that appropriate financial information was not available for many of the leases we reviewed, we have not been able to quantify the loss of revenue to the City.

While it is our opinion that significant improvements in the management of the lease portfolio are required, the Facilities and Real Estate Division, in particular, has recognized and taken steps to remedy certain shortcomings. During the 2005 budget process, an operating business case was developed for two additional contract staff, with the objective of increasing revenues and collecting outstanding receivables relating to the City's existing lease portfolio. Increased revenue and improved cash flow generated by the two additional staff has exceeded expectations. While this outcome is clearly positive, it indicates the extent to which the area has been poorly managed in prior years.

During the course of our review we have had discussions with City Legal in relation to certain disputed lease agreements which are either in litigation or are being considered for litigation. These discussions were initiated in order to determine the nature of legal concerns relative to the management of the City's lease portfolio and to provide an additional audit focus on the areas of concern. Our discussions with City Legal have confirmed certain of the issues identified during our review. The concerns now being addressed by City Legal are in fact the end result of a lease management process in need of significant improvement. The legal repercussions inevitably will include legal costs which could have been avoided if the leases were appropriately managed at the outset. For instance, City Legal is now reviewing and evaluating various lease agreements where lease provisions have not been complied with generally because of a lack of management oversight. For instance, certain lease provisions require that tenants pay the City the greater of a fixed rent amount or a percentage of revenue. In these cases, audited financial statements are required to be produced by the tenant to the City in order determine whether or not the City is entitled to a percentage of revenue. In one case we reviewed, financial statements had not been provided since 1992 and, in another case, financial statements had not been provided since 1995. Both of these leases are now being reviewed by City Legal.

We have also had discussions with City Legal in connection with one particular leased property which has been classified incorrectly as tax exempt for a significant number of years. City Legal is now attempting to recover unpaid realty taxes from this particular tenant.

What is particularly disconcerting is the fact that our audit findings are based on a review of a relatively small number of leases. It is likely that additional concerns exist in many of the leases which we have not reviewed. In this context, it is important that management review the findings in this report as soon as possible and take immediate action to address the concerns identified. Our report has been reviewed with the City Manager and senior management and as a result they are aware of the issues identified.

The body of the report contains detailed information in support of our recommendations. In summary, however, the more important concerns centre around the absence of an appropriate level of management review of the lease portfolio and the absence of effective tools to be able to conduct such a review. A significant number of leases have expired and there are a number of cases of non-compliance with lease provisions and, in other cases, the City is not receiving the rental income to which it is entitled. In addition, roles and responsibilities are unclear in terms of the management of certain leases, and further improvements are required in the collection of outstanding receivables. Finally, issues in connection with the implementation of the City's policy relative to properties being leased at below-market rent need to be addressed.

The implementation of the recommendations in this report will provide the City with a significant opportunity to improve the way it manages its leasing operations, address internal management controls identified during the course of this review and, where appropriate, generate additional revenue. These issues should be dealt with immediately.

BACKGROUND TO THE AUDIT

2006 Work Plan – Why this Audit?

In 2005, the Auditor General conducted a review on Maintenance and Administrative Controls in the Facilities and Real Estate Division within the Office of the Chief Corporate Officer. In formulating the Auditor General's Work Plan for 2006, it was determined that the concerns raised in the 2005 report would likely have some relevance to controls relating to leasing income earned from all City-owned properties. Consequently, it was determined that the Auditor General's 2006 Work Plan should include a review of the controls relating to leasing income.

This is the first review by the Auditor General of the administration of leases on City-owned property.

Who is responsible for the day-to-day management of lease agreements? How much income does the City generate from its leasing activities?

In 2005, the City reported approximately \$20 million in rental income. Of this amount, \$17.5 million relates to the Facilities and Real Estate Division which manages approximately 650 properties leased to third parties, and \$1.8 million from the Parks, Forestry and Recreation Division which manages 340 leased properties. Other City divisions reported \$795,000 in rental income from approximately 70 properties.

Accounting responsibilities for rental income. Who is responsible?

The billing and collection of rents for City-owned property are handled by different City Divisions. The Accounting Services Division within the Office of the Treasurer is responsible for the billing and collection of receivables for the Facilities and Real Estate Division. The Social Development, Finance and Administration Division within the Deputy City Manager's Office, administers the billing and collection of rental income for the Parks, Forestry and Recreation Division as well as other City divisions.

What type of leases does the City have?

As a result of amalgamation in 1998, the City inherited a variety of lease arrangements made by former City Councils. There are many types of leased properties (commercial, residential, heritage, below-market rent and vacant land) with different financial, operational and legal requirements. A complete profile of the City's lease arrangements detailing lease duration, type of lease and geographic distribution of leased space is not currently available.

The City's leasing program also includes lease arrangements to provide space to organizations, generally not for profit groups, at below-market rent in accordance with the City's "Policy on City-Owned Space Provided at Below-Market Rent", approved by City Council in 2002.

AUDIT OBJECTIVES, METHODOLOGY AND SCOPE

What were the objectives of the Audit?

Our overall audit objective was to assess whether leased City-owned property was being managed effectively, and to ensure that lease arrangements were in compliance with City policies and other legislative requirements. Where properties are rented in accordance with City Council's "Policy on City-Owned Space Provided at Below-Market Rent", our review included an evaluation as to whether there was compliance with this policy.

How did we conduct this Audit?

Our audit methodology included the following:

- review of legislation, regulations, directives, policies and procedures, and current City practices;
- interviews with staff of the Facilities and Real Estate Division, Parks, Forestry and Recreation Division, City Legal and other City divisions;
- review of various legal correspondence relating to leases which are subject to litigation or pending litigation;
- review of a sample of various lease agreements and other documents and records;
- review of various audit reports issued by audit organizations of local governments throughout Canada, and the U.S.;
- review of various audit reports issued by the Auditor General of Canada;
- review of audit reports issued by a number of Provincial Auditor Generals;

- review of audit reports issued by the Australian National Audit Office;
- review of City Council reports;
- evaluation of management controls; and
- other procedures as we considered appropriate.

Scope of the Audit. What did the Audit include and what did the Audit exclude?

This audit was conducted in accordance with generally accepted government auditing standards. Our audit covered the period of January 1, 2005 to March 31, 2006 and included the review of rental income and lease agreements for City-owned property only. Due to the fact that the majority of leases are managed by Facilities and Real Estate and Parks, Forestry and Recreation our audit focus was on these two Divisions. The scope of this audit did not include rental income from the St. Lawrence Market in the Facilities and Real Estate Division or concession revenue in the Parks, Forestry and Recreation Division. Rental income earned by the City's Agencies, Boards and Commissions was also excluded from this review.

As is the case with the vast majority of audits this review was conducted on a test basis only. Our observations are based on a limited review of 50 lease agreements.

AUDIT RESULTS – WHAT DID WE FIND?

A. LEASE AND FINANCIAL INFORMATION TO EFFECTIVELY MANAGE THE CITY'S LEASE PORTFOLIO REQUIRE IMPROVEMENT

A.1. An Accurate and Complete Inventory of Lease Agreements Does Not Exist

The City does not maintain a centralized complete inventory of its lease agreements. The Facilities and Real Estate Division and the Parks, Forestry and Recreation Division each

maintain their own separate lease inventories. Both inventories are inaccurate and incomplete. We found errors and incomplete lease information in the Parks, Forestry and Recreation Division inventory listing relating to rental amounts, names of tenants, and the expiry dates of leases. In addition, certain lease information such as the expiry date of leases, the amount of square footage of property rented and rental amounts were not recorded in the Facilities and Real Estate Division lease inventory. Further, we identified two leases for Parks, Forestry and Recreation Division and 45 leases for the Facilities and Real Estate Division that were not recorded on either leasing inventory listing. While the 45 leases for the Facilities and Real Estate Division included one building with 44 leases managed by an external property manager, the inventory listing was incomplete and did not provide accurate information on these leases.

Without an accurate and up-to-date lease inventory, City staff responsible for the administration of the lease portfolio do not have access to the appropriate level of lease information to enable them to effectively monitor compliance with lease provisions, determine lease expiry dates and make effective leasing and property decisions.

Recommendation:

1. The City Manager ensure that a centralized inventory of leases for City-owned property is prepared and that all lease information included in this inventory is accurate and complete. The inventory should include information relating to rental amounts, lease expiry dates, details of the property being leased and details relating to the tenant. Information contained in the inventory of City property and maintained by the Facilities and Real Estate Division should be reconciled to the inventory of property leases. Any items which do not reconcile should be reviewed and appropriate action taken.

A.2. The Responsibility for the Management of Certain Leases is Unclear

During our review of certain lease agreements, it was evident that there is uncertainty concerning the responsibility for managing certain leases. It is not clear which City Division has the

responsibility for managing the leases of certain City-owned properties. For instance, some leases recorded in the inventory of the Parks, Forestry and Recreation Division appear to be managed by the Facilities and Real Estate Division. In one case, it appeared as if both Divisions were managing one particular leased property. In this case a residential property located on parkland and acquired in 1992 had been scheduled for demolition, subject to the availability of funds. In the intervening years, the property was managed by the Facilities and Real Estate Division and rented to a third party until it became vacant in 2002. Given the uncertainty over the availability of funds to demolish the building, in 2004, the Facilities and Real Estate Division spent \$30,000 on capital repairs for the building with the intent of renting it again. For various reasons, the building has not been rented again and, in 2006, funds became available and the building is planned for demolition by Parks, Forestry and Recreation Division.

In our September 2005 audit report entitled, “Maintenance and Administrative Controls Review – Facilities and Real Estate” we recommended that the City Manager review the governance structure of the building maintenance program with a view to clarifying specific responsibilities of different City Divisions. This review is currently underway although very much in its early stages. We have met with the consultant from the City Manager’s Office responsible for the management of this particular review and have discussed in general terms the findings contained in this current report.

It is the view of the City Manager and the consultant that the current governance review should proceed and be completed as expeditiously as possible. In this context, we have been advised that a review of the management of the City’s lease portfolio is not included in the terms of reference for this particular project. We appreciate the City Manager’s wish to proceed with current review and would anticipate certain of the conclusions in that review having some relevance to the leasing program.

Recommendations:

- 2. The City Manager, at the conclusion of the review of the governance structure relating to the City's property maintenance program, give consideration to how the recommendations resulting from the governance review may have relevance to the management of the City's lease portfolio.**

- 3. The City Manager, in consultation with the appropriate General Managers, ensure that all leases contained in the final inventory listings are clearly assigned to appropriate Divisional staff. Staff be advised of such assignments and be held accountable for the efficient and effective management of all leases within their portfolio.**

A.3. Revenue and Cost Information for Each Leased Property Has Not Been Determined

Information relating to the revenue and costs for each of the City's leased properties is not available. Accurate and complete revenue and cost information for each property is not being accounted for in the SAP Financial Information System. Consequently, it is not possible to evaluate the financial performance of individual properties. Without such information, it is not possible to determine the level of rental income required to generate an appropriate level of return on the City's investment.

The Parks, Forestry and Recreation Division does not maintain a separate cost centre for each leased property. Rental income from many leases is being charged to one cost centre which also includes other program expenses unrelated to the leased properties. As a result, it is not possible to determine the operating costs for each leased property.

The Facilities and Real Estate Division has established a cost centre in the SAP Financial Information System for each leased building recorded in its lease inventory. However, because a number of buildings are not recorded in the lease inventory, it is not possible to identify revenue

and expenses for all leased buildings. In addition, there are no cost centres for some land leased by the City.

Without accurate rental revenue and cost information, it is not possible to determine the financial performance of individual leased properties or the City's leasing program as a whole. Reliable financial information is required to develop budget estimates and to make effective leasing decisions.

Recommendation:

- 4. The Deputy City Manager and Chief Financial Officer take steps to ensure that accurate and complete revenue and cost information for each leased property is accounted for in the SAP Financial Information System by requiring that:**
 - (a) separate cost centres are maintained in the SAP Financial Information System for each leased property and all property revenue and expenditures are charged to separate property cost centres;**
 - (b) financial reports for individual leased properties are prepared, reviewed and approved by senior staff. Financial results which are unexpected and unusual be identified and appropriate action taken; and**
 - (c) the financial performance of properties be reviewed and evaluated prior to the negotiation of lease agreements. Evidence of such review be contained in all leasing files.**

A.4. SAP Lease Management Function Should Be Implemented City-wide

The Facilities and Real Estate Division is in the process of implementing the SAP Real Estate Module to manage the City's real estate portfolio. The first phase, the portfolio management function, which provides one central database for property information, became operational in

April 2006. The second phase, the lease management function, is currently being piloted by the Facilities and Real Estate Division with an expected implementation in early 2007.

The lease management function will be linked to the land and building portfolio and integrated with the SAP Financial Information System. The integration of both systems will facilitate a more effective lease management process. The integration will also eliminate duplicate data entry and reduce the risk of error. The SAP lease management function also has the capacity to identify property vacancies and track key dates, such as expiry dates, contained in leases.

The full implementation of the SAP Real Estate Module will also provide management reporting capability that does not currently exist for lease and property information.

The Parks, Forestry and Recreation Division is currently upgrading its lease information in a separate system using Microsoft Access. This system will provide similar information to the SAP system being developed in the Facilities and Real Estate Division although it does not have the reporting capabilities available in SAP. The Parks, Forestry and Recreation Division is not currently implementing the SAP Real Estate Module or participating in the design of the system. It is our understanding that the Parks, Forestry and Recreation Division will migrate to the SAP module once it is fully implemented by the Facilities and Real Estate Division. According to management, there are no plans to link the Microsoft Access system to the SAP Real Estate Module.

The continued development of Microsoft Access is being conducted in isolation from the development of the SAP module in Facilities and Real Estate. The development of a separate system using Microsoft Access in our view is a duplication of a system currently under development.

Recommendation:

5. The City Manager take appropriate steps to implement the lease management function of the SAP Real Estate Module for all City leases, including those administered by the Parks, Forestry and Recreation Division. Unless there are compelling reasons to the contrary, the future development of alternative management information systems be discontinued.

B. THE MANAGEMENT OF LEASE AGREEMENTS IS INADEQUATE AND REQUIRES IMMEDIATE ATTENTION

B.1. The Execution and Timely Renewal of Lease Agreements Requires Improvement

The Facilities and Real Estate Division and the Parks, Forestry and Recreation Division have each implemented a manual tracking system to identify lease expiry dates. This system is ineffective as up-to-date signed lease agreements do not exist for certain leased properties. For example, we could not locate current signed lease agreements for six of the 25 leased properties reviewed relating to the Facilities and Real Estate Division. Similarly, the lease files for the Parks, Forestry and Recreation Division did not include up-to-date signed agreements for 11 of the 20 leases reviewed.

While the absence of signed agreements is an issue, of even more concern is the length of time certain of these properties have been without signed agreements. For example, of the 25 leases reviewed for the Facilities and Real Estate Division, three leases had been expired for over one year. For the Parks, Forestry and Recreation Division, three of the 20 leases reviewed had been expired for over one year. In addition, based on information provided to us by management it appears as if six leases managed by the Shelter, Support and Housing Administration Division, have been expired for more than one year.

Each of the expired leases, by default, has been extended under the same terms and conditions of the original lease. As a result, tenants have continued to pay the same rent. The lack of timely renewal of leases has the potential to cost the City additional rental revenue.

Recommendation:

6. The City Manager take steps to:

- (a) review the status of all City lease agreements in order to ensure that every agreement is current. Immediate action be taken to finalize all expired leases; and**
- (b) ensure that the SAP property management module currently being developed includes a facility to identify lease expiry dates well in advance of the actual expiry date so that expiring leases are identified and renewed on a timely basis.**

B.2. Provisions Contained in Certain Lease Agreements Are Not Being Addressed By Management

Commercial lease agreements sometimes require the payment of a fixed rent amount as well as “additional rent” usually defined either as the tenant’s share of operating costs, utilities and property taxes or a percentage of revenue earned.

During our review, we identified instances where the Facilities and Real Estate Division has not received its share of revenue earned as provided for in various lease agreements. In these particular cases, financial statements have not always been provided to the City so that the amounts of “additional rent” can be determined. It also appears as if demands for financial statements have not been made by City staff. In one particular case, “additional rent” has not been paid since 1992, due to the fact that financial statements have not been provided to the City. In another case, it appears that the additional percentage of revenue has never been paid. In this

case, the rent outstanding is in the range of \$260,000, which represents unpaid percentage rent for the last six years.

We also identified a number of situations where certain tenants were not paying “additional rent” such as operating costs as required under the lease agreement.

Recommendation:

- 7. The City Manager direct that a complete review of all lease agreements be initiated in order to ensure that all tenants are paying rent in accordance with specific provisions in lease agreements. Where lease payments are less than contractual amounts, efforts be made, in consultation with City Legal, to recover underpayments. A formal ongoing reporting process be established to ensure that appropriate lease payments are made on a timely basis.**

B.3. Leasing Policies and Procedures Should Be Established

The Facilities and Real Estate Division and the Parks, Forestry and Recreation Division each has limited documentation relating to the steps required in the leasing of City-owned property. A formal policies and procedures manual for the leasing of City-owned properties does not exist.

Written leasing policies and procedures should include the steps required for the negotiation of leases, the determination of lease amounts, the supervisory review and approval of all negotiated leases, the involvement of City Legal in the negotiation and finalizing of lease agreements, the monitoring of provisions contained within the leases, the accounting for and collection of rents and termination procedures for lease agreements. Approved policies and procedures provide guidance for all City staff responsible for the administration of leases as well as facilitating the training of new staff.

Recommendation:

- 8. The City Manager, in consultation with City Legal, direct that a policies and procedures manual for the administration of the leasing of all City-owned property be developed.**

B.4. Compliance with Operational Provisions Within Lease Agreements Requires Attention

A formal lease compliance program is not in place to ensure compliance with key operational provisions in lease agreements. Leasing staff of the Facilities and Real Estate Division and the Parks, Forestry and Recreation Division have advised that property inspections are not conducted during the term of the lease, due to resource limitations. Leases are generally only given attention after problems are identified as a result of complaints. Without periodic property inspections, properties may be operated in contravention of lease provisions. Such actions may expose the City to financial risk. For instance, during our review we noted two leases where the tenant had sublet its property without City permission in contravention of its lease agreement. While the lease files indicated that the City was aware of the subleases, there is no information on file to indicate what action, if any, was taken to address the non-compliance.

Recommendation

- 9. The City Manager:**
 - (a) establish a formal lease compliance program in order to ensure that tenants are in compliance with key operational provisions contained within lease agreements; and**
 - (b) occurrences of non-compliance identified during property inspections be followed up on a timely basis and appropriately documented.**

B.5. Insurance Provisions Within Lease Agreements Are Not Being Complied With

Our review indicated that the monitoring of insurance coverage on City-owned properties was ineffective. For instance, the Facilities and Real Estate Division could not provide documentation of current insurance for three of the 20 non-residential leases reviewed. Only two of 20 leases reviewed for the Parks, Forestry and Recreation Division had evidence of up-to-date insurance coverage. A lack of insurance coverage exposes the City to significant financial risk.

Recommendation:

- 10. The City Manager ensure that up-to-date and adequate insurance coverage for all properties leased by the City is obtained. Evidence of insurance coverage be included in all lease files.**

B.6. Market Rents Should Be Independently Determined

Independent market valuations are not always conducted for leased properties. According to the Parks, Forestry and Recreation Division leasing staff, new lease agreements are generally competitively bid through a request for proposal process which determines a fair market rate. Our review identified two leases within the Facilities and Real Estate Division, where a market valuation was not conducted prior to lease renewal and the lease was renewed based on existing terms and conditions. The renewal of leases presents an opportunity to increase rental income and update the financial and operational provisions particularly for older lease agreements.

Without independent valuations of market rent, there is no assurance that the City is maximizing the rental income generated from its leased properties. While these valuations may be performed by City staff, they should be independent of staff responsible for negotiating the rent amount with the tenant.

Recommendation:

- 11. The City Manager ensure that, wherever possible, lease amounts are established through an independent valuation process such as the use of an appraisal process or through competitive bids. Evidence of such a process be documented and retained in lease files.**

B.7. No Formal Plan Exists to Identify and Lease Vacant Property

The City is currently not aware of the extent of its vacant property. In addition, a structured proactive process is not in place to identify and market those properties. Consequently, certain properties may be vacant for an inordinate amount of time. If properties are not leased on a timely basis, the City is not maximizing its revenue.

Recommendation:

- 12. The City Manager ensure that all vacant City properties available for lease are identified. A proactive process be initiated to ensure that all such properties are marketed on a timely basis.**

B.8. Option of Assigning the Management of the City's Leasing Portfolio to an External Party Should Be Considered

We have been advised by staff in both the Facilities and Real Estate Division and the Parks, Forestry and Recreation Division, that there are inadequate City staff resources to effectively manage the City's lease portfolio. For example, the Parks, Forestry and Recreation Division has assigned only two leasing staff to manage over 340 agreements. The staff available in the Facilities and Real Estate Division to manage approximately 650 leases consists of 12.5 full-time staff and at present five temporary staff.

Our review did not assess the adequacy of staff resources although it is clear based on the issues we have identified that the management of the City's lease agreements leaves much to be desired. Our initial assessment of the level of staff resources would conclude that inadequate resources is certainly one factor contributing to the issues we have identified.

Options to address the concerns identified appear to be twofold. One option is to increase the staff resources and evaluate the results of this increase on an ongoing basis. The second option would be to assign all or part of the management of the City's lease portfolio to an external management company.

Recommendation:

- 13. The City Manager review the capacity of current in-house leasing staff to deliver an effective leasing program, and based on this review assess whether there is a financial and operational advantage to assigning the administration of the leasing of City-owned property in whole or in part to an outside property management company. Detailed cost benefit analyses be an integral part of this evaluation.**

C. THE MANAGEMENT OF CITY-OWNED PROPERTY PROVIDED AT BELOW-MARKET RENT REQUIRES RE-EVALUATION

Background

As a result of amalgamation in 1998, the City inherited a variety of lease arrangements approved by former City Councils to provide City-owned space to outside organizations, mostly not-for-profit organizations, at below-market rent. In 2002, City Council approved a policy to harmonize below-market rent lease arrangements and to provide a "consistent, fair, accountable and transparent approach" to the "exclusive use of City-owned space by community and cultural organizations".

In 2002, an inter-departmental team comprised of representatives of the former departments of Corporate Services, Community and Neighbourhood Services and Economic Development, Culture and Tourism was established to oversee the implementation of the below-market rent policy. The team refined the below-market rent policy and eligibility criteria and developed a three-year implementation plan that would conclude with new standardized leases, and service contracts for all current tenants. It is our understanding that a joint report to the Policy and Finance Committee from the Social Development, Finance and Administration Division and the Facilities and Real Estate Division, planned for September 2006, will address standard lease terms and conditions and tenant service contracts, which will ensure that a tenant's activities remain consistent with City objectives.

C.1. Eligibility Should Be Assessed for All Below-market Rent Leases

During Phase One of the below-market rent implementation plan, an evaluation of the eligibility of below-market tenants was conducted. During our review of this process, we identified a number of concerns which should be addressed.

Our review identified the fact that the inventory of below-market rent leases was not complete. As a result, some leases were omitted from the eligibility review. In addition, the current policy does not set out any eligibility criteria for tenants benefiting from below-market rent for land or who currently have purchase of service agreements with the City. As a result, the eligibility of many below-market tenants, (42 of a total of 98 identified by staff in the April 2005 report to Council), have not yet been assessed.

Recommendation:

14. The City Manager ensure that:

- (a) the inventory of below-market rent leases for City-owned properties is accurate, up-to-date and complete; and**

- (b) **the below-market rent policy addresses tenants who receive below-market rent for land or who have purchase of service agreements with the City.**

C.2. Financial Assessment Should Determine Below-market Rent

Below-market tenants generally pay the City a nominal rent and are required to pay their own utility and operating costs. All below-market tenants are not-for-profit and or charitable organizations but differ in their financial capacity to pay rent. Some organizations with limited financial resources may not be able to pay operating costs which may result in the City assuming these costs. Other organizations who have received below-market rent may be financially capable of paying market rent and do not require a rent subsidy.

A financial assessment of organizations applying for below-market rent should be conducted so that the amount of any rent subsidy is determined according to the financial capacity of each applicant organization. This is consistent with the City's grants policy.

Recommendation:

15. The City Manager ensure that:

- (a) **a detailed financial assessment is conducted for all organizations being considered for below-market rent; and**
- (b) **the amount of any rent subsidy provided to organizations be based on the financial capacity of organizations to pay rent.**

C.3. Clear and Measurable Criteria for Determining Eligibility are Needed

City Council established four criteria that organizations must meet to qualify for below-market rent. These criteria are as follows:

- not-for-profit or charitable status;

- activities serve City residents;
- activity supports City objectives; and
- applicant/tenant mandates are not the responsibility of senior levels of government.

The criteria, “activities serve City residents” and “activity supports City objectives”, are neither specific nor measurable and consequently, most non-profit and charitable organizations would likely meet these criteria.

Recommendation:

- 16. The City Manager review the City’s eligibility criteria for the below-market rent policy with a view to making them more specific and measurable.**

C.4. Assessments Should Be Conducted to Establish Priorities for Below-market Rent

The ranking of below-market rent applicants according to priority, which is included in the implementation plan, has not yet been completed. The primary goal of the below-market rent policy is to provide space to community and cultural organizations to help “the City achieve its goals for its residents and complement the City’s programs and services”. However, the City has not assessed the benefits being derived from current tenants occupying below-market rent space. In addition, the City has no process in place to identify gaps in services where the allocation of below-market space would most benefit its residents.

Recommendation:

- 17. The City Manager establish priorities for providing below-market rent space. The City should allocate below-market space to organizations providing services which will most benefit its residents.**

C.5. Subsidy Amount for Below-market Rent Leases Should Be Reported

City Council currently approves individual below-market lease agreements with organizations without being advised of the approximate amount of the rent forgiven. Council is also not advised of the amount of other City grants provided to these organizations. This is not in compliance with the below-market rent policy, which states that Council reports seeking approval for leasing space at rates below-market disclose “the opportunity cost of providing the space and other assistance being provided by the City to the tenant such as grants and property tax rebates”. In addition, a recent Council report requesting renewal for a below-market lease did not make any reference to the below-market rent policy.

In 2001, the Auditor General (the then City Auditor) in his report entitled “Community and Neighbourhood Services – Community Services Grants Program Review”, recommended that the value of in-kind grants such as office space provided at less than market rate be determined. Also, in approving a 2002 report regarding the below-market rent policy, City Council recommended that “the Chief Administrative Officer, in her forthcoming report respecting the City of Toronto’s grants program, be requested to identify the dollar value of rent subsidies”. The amount of rent subsidy provided to below-market tenants has not been determined. As a result, it is not possible to determine grants in-kind provided by the City for individual lease agreements or for the City as a whole.

Presently there is no accounting for grants in-kind. The Community Services Grants Program is currently piloting a new Corporate Grants Information System for all City grants. Grants in-kind for below-market rent could be incorporated into this system.

Recommendation:

18. The City Manager ensure that:

- (a) Council reports seeking approval or renewal for leasing space at rates below-market contain the opportunity cost of providing the below-market space; and**
- (b) the accounting of all grants in-kind be incorporated into the Corporate Grants Management Information System currently being developed for all City grants.**

C.6. Eligibility Reviews for Below-market Rent Tenants Should Be Consistently Followed and Documented

Assessments of eligibility for below-market tenants are conducted independently by several City divisions. The review checklist requires a site visit, a review of the current lease agreement and an evaluation of audited financial statements. There was no evidence on file that site visits were conducted for most below-market leases. Also, information confirming the review of lease agreements and audited financial statements was not always in the lease file.

Recommendation:

- 19. The City Manager ensure that eligibility reviews conducted for below-market tenants include, where practical, a site visit and a review of other required documentation such as the lease agreement and financial statements. Evidence of completion of the eligibility review, including copies of documentation, should be retained in the lease file.**

D. THE COLLECTION OF RENTAL INCOME REQUIRES ADDITIONAL ATTENTION

D.1. Overdue Accounts Require Prompt Follow-up

Our review of receivable accounts outstanding for longer than 90 days indicated that a consistent and ongoing effort has not been made by staff to collect certain of these accounts.

The lack of timely follow-up of overdue accounts is evident in errors in receivable balances in the SAP Financial Information System that were not identified and corrected on a timely basis. For example, in one instance where the tenant had vacated the leased premises in December 2004, staff of the Accounting Services Division, who are responsible for billing and collecting rent, were unaware of the lease termination and continued to account for the revenue each month. Consequently, rental income over a two-year period was overstated by approximately \$27,000 as of March 31, 2006. The Accounting Services Division provided an aged accounts receivable listing to the Facilities and Real Estate Division but appropriate follow-up action was not taken.

The Facilities and Real Estate Division has recently taken steps to address concerns by hiring two additional contract staff to address the problems with overdue rental accounts.

The Accounts Receivable section in the Accounting Services Division is responsible for the billing and collection of receivables for the Facilities and Real Estate Division. Collection reminder letters sent to tenants for late rental payments are manually created and are not always prepared and sent out on a timely basis. We understand the SAP Financial Information System can be upgraded to automatically produce standard collection reminder letters. This function is due for implementation later this year.

Accounts receivable collection policies and procedures are being implemented that clearly outline the past due amounts collection process. The policies state that a “pre-authorized payment program” can be set up “if the account is of a recurring nature and agreed to by the

customer”. Using post-dated cheques and requiring deposits from customers are also optional methods to ensure timely rental payment.

Recommendations:

- 20. The Deputy City Manager and Chief Financial Officer upgrade the SAP financial information system to automatically produce standard collection reminder letters as soon as possible. When this functionality is implemented, all City Divisions responsible for the billing and collection of accounts receivable be required to use it to create timely reminder notices for all overdue accounts and such notices be sent out on a regular basis.**
- 21. The Deputy City Manager and Chief Financial Officer, in consultation with City Legal, require that all new tenants be mandated to participate in the pre-authorized payment program or provide post dated cheques or rental deposits in advance as a means of collecting rental income on a timely basis.**

D.2. The Accounting for Rental Income and Rental Receivables Should Be Reviewed

As indicated earlier many lease agreements contain provisions that require the payment of “additional rent”. These amounts can be significant but are not being accounted for correctly as the revenue is only recorded when rents are received.

In circumstances where the “additional rent” can be reasonably estimated, it should be recorded in the accounting records as revenue and a receivable. Accounting for these amounts as a receivable also serves to notify management that “additional rent” is due as well as provide management with more accurate reporting of accounts receivable.

In accordance with the City By-law, Council approval of the write-off of all non-collectible accounts greater than \$10,000 is required. Unless receivables are properly accounted for, it is possible that receivables not recorded in the accounting records could be written off without

Council approval. While we have not identified any instance of this happening, the potential does exist for this to occur. This is a fundamental internal control issue which should be rectified as soon as possible.

Recommendation:

22. The Deputy City Manager and Chief Financial Officer ensure that:

- (a) all revenue from existing leases containing provisions for “additional rent” are reviewed to ensure that all rental income is accounted for correctly;**
- (b) all revenue from future leases, including “additional rent”, is accounted for appropriately and recorded as revenue and accounts receivable in the SAP Financial Information System when earned; and**
- (c) all write-offs of outstanding receivables greater than \$10,000, irrespective of whether or not they have been accounted for in the City’s records, be approved by City Council.**

D.3. Late Payment Charges Should Be Imposed on Overdue Receivable Accounts

In December 2005, City Council approved a policy requiring that “late payment charges shall be added to all fees and charges that are due and payable at the rate of 1.25 per cent on the first day of default, and every 30 days thereafter during such time as the default continues”. In 2005, a notice was sent to tenants advising them of the City’s intent to start imposing late payment charges on all overdue accounts. However, as of July 2006, this policy has not been implemented and as a result no late payment charges have been collected on overdue accounts. We understand that the delay in implementing late payment charges is due to the requirement to clarify a number of legal concerns with City Legal.

Recommendation:

- 23. The City Manager, in consultation with City Legal, clarify the legal concerns pertaining to the imposition of late payment charges on outstanding accounts and where possible such charges be imposed as soon as possible.**

D.4. Tenant Arrears Should Be Collected Prior to Lease Renewal

Prior to the negotiation of lease renewals, all outstanding receivables should be collected and any operational issues with the tenant should be resolved. At that point in time, the City is in its strongest negotiating position and as a result, the City has its best opportunity to resolve any outstanding issues. In certain cases, leases contain renewal clauses indicating that “provided that tenants are not in default under any of the terms, conditions and covenants hereunder ... there shall be an option to renew for a further...” Unless there are compelling reasons to the contrary, lease agreements should not be renegotiated until all disputed matters are addressed to the satisfaction of the City.

City Legal has indicated that, in one particular case, audited financial statements were not provided as required and percentage rent was not paid for the period 1995 to 2000. Despite this default, a new lease was negotiated.

Recommendation:

- 24. The City Manager ensure that prior to renewing any lease agreement direction be sought from City Legal in order to ensure that there is compliance with any lease renewal provisions and in addition all outstanding receivables are collected prior to the commencement of negotiation of any lease renewal.**

E. RELEVANCE TO OTHER ORGANIZATIONS

The recommendations contained in this report may have relevance to those City of Toronto Agencies, Boards and Commissions who manage property leased to third parties. These Agencies Boards and Commissions would likely include the Toronto Transit Commission, the Toronto Parking Authority and the Toronto Public Library Board. Consequently, this report should be forwarded to them for their review and consideration.

Recommendation:

- 25. City Council direct that this report be forwarded to the City's major Agencies, Boards and Commissions in order to ensure that concerns, issues and recommendations raised in this report are considered and addressed where appropriate.**

CONCLUSION

This report represents the results of a second review by the Auditor General's office of certain operations within the Facilities and Real Estate Division. The first phase encompassed a review of the Maintenance and Administrative Controls within the Division. This current review focused on the administration and management of leases on City-owned property.

Included and concurrent with the review of leases in the Facilities and Real Estate Division was a review of leases administered by the Parks, Forestry and Recreation Division. Other reviews conducted in the Parks, Forestry and Recreation Division over the past number of years have included controls over cash management within the Recreation areas and an evaluation of the effectiveness of receivable collection procedures.

All of these reviews have resulted in a significant number of recommendations generally because they represented first time audits, since amalgamation, of the operations of each Division.

We have previously reported on the status of the implementation of the recommendations contained in all previously issued audit reports including the ones mentioned above. Our review on the status of the recommendations very clearly indicates a firm commitment by management to address shortcomings outlined in these reports.

This current review has identified internal control weaknesses in how the City's leases are managed. The weaknesses identified exist in both Divisions. Significant work will be required to address the deficiencies which we have outlined. Increased management oversight will be an important factor in addressing these concerns. Continued commitment to implement the recommendations contained in this current report will contribute to a more effective and efficient operation in both the Facilities and Real Estate and Parks, Forestry and Recreation Divisions.

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**Management Response to the Auditor General’s
Review of the Administration of Leases on City-owned Property**

Recommendation	Management Response
<p>1. The City Manager ensure that a centralized inventory of leases for City-owned property is prepared and that all lease information included in this inventory is accurate and complete. The inventory should include information relating to rental amounts, lease expiry dates, details of the property being leased and details relating to the tenant. Information contained in the inventory of City property and maintained by the Facilities and Real Estate Division should be reconciled to the inventory of property leases. Any items which do not reconcile should be reviewed and appropriate action taken.</p>	<p>Staff are in agreement with the recommendations in the Auditor General’s report and the direction that these recommendations will lead the City in the management of its leasing portfolio. Staff have already started the process to change the way leasing is performed at the City. These changes include:</p> <ol style="list-style-type: none"> 1) 2003/2004 – A re-organization of the Real Estate Unit to improve work flow by separating daily project and policy work streams; 2) 2004 – Real Estate begins development of the SAP Real Estate Leasing module to automate business processes. The system will be implemented in April 2007; 3) 2005 – 4 temporary staff were hired to review the accuracy and status of all leases and to develop an accurate and complete inventory of leases; and 4) 2006 – 2 temporary Revenue staff were hired to maximize revenue from percentage rent leases, collect outstanding arrears, resolve tax issues and to develop new revenue generation opportunities. <p>Future endeavours will include the potential to “tie in” other divisions with leasing responsibility and the assessment of private sector opportunities to help maximize the City’s portfolio. Real Estate is also contemplating establishing a centre of expertise in the area of property taxes to deal with tax issues for all City leased/owned properties.</p>

**Management Response to the Auditor General’s
Review of the Administration of Leases on City-owned Property**

Recommendation	Management Response
	<p>We concur that a centralized inventory of leases would be beneficial. Staff is aware of the fact that leases require updating and are taking steps to address this issue.</p> <p>When the SAP system in Facilities & Real Estate (F&RE) will be implemented in April/2007, the lease information recommendations will be addressed. With reference to the notification of the leasing inventory, Portfolio staff will continually be responsible for maintaining the lease information within the sole portfolio database.</p> <p>Parks Forestry & Recreation (PF&R) is using an ACCESS database system on an interim basis. At amalgamation, PF&R received lease data from former municipalities that came in different formats and which were prepared using different software. Given that there was no City system in place, PF&R established their own inventory system.</p> <p>PF&R has determined that the SAP module will provide the data they need to manage their portfolio of leases</p> <p>PF&R will migrate to the corporate SAP Real Estate module following completion of the pilot project in April 2007 in Facilities & Real Estate. Costs associated with the introduction of the SAP Real Estate module has been incorporated into the 2007 budget.</p>

**Management Response to the Auditor General’s
Review of the Administration of Leases on City-owned Property**

Recommendation	Management Response
<p>2. The City Manager, at the conclusion of the review of the governance structure relating to the City’s property maintenance program, give consideration to how the recommendations resulting from the governance review may have relevance to the management of the City’s lease portfolio.</p>	<p>Agree: One of the objectives of the review of the governance structure relating to the City’s property maintenance program is to determine the feasibility of centralizing ownership, control, accountability and maintenance operations of City buildings, within F&RE.</p> <p>Upon completion of this review, we will assess whether the recommendations resulting from the governance review has any relevance/applicability to the management of the City’s lease portfolio.</p>
<p>3. The City Manager, in consultation with the appropriate General Managers, ensure that all leases contained in the final inventory listings are clearly assigned to appropriate Divisional staff. Staff be advised of such assignments and be held accountable for the efficient and effective management of all leases within their portfolio.</p>	<p>Agree: It is recognized that jurisdictional issues with respect to responsibility for the management of certain leases needs to be addressed. Management of the lease portfolio will be reviewed when the governance structure relating to the City’s property maintenance program is completed.</p>

**Management Response to the Auditor General’s
Review of the Administration of Leases on City-owned Property**

Recommendation	Management Response
<p>4. The Deputy City Manager and Chief Financial Officer take steps to ensure that accurate and complete revenue and cost information for each leased property is accounted for in the SAP Financial Information System by requiring that:</p> <p>(a) separate cost centres are maintained in the SAP Financial Information System for each leased property and all property revenue and expenditures are charged to separate property cost centres;</p> <p>(b) financial reports for individual leased properties are prepared, reviewed and approved by senior staff. Financial results which are unexpected and unusual be identified and appropriate action taken; and</p> <p>(c) the financial performance of properties be reviewed and evaluated prior to the negotiation of lease agreements. Evidence of such review be contained in all leasing files.</p>	<p>(a) Agree: We agree that there is a need for complete revenue and cost information for each property.</p> <p>It should be noted however, that a corporate initiative is currently underway to rationalize the number of cost centres. Accounting Services will work with F&RE to ensure that the SAP Real Estate module will be able to accommodate the informational requirements necessary to evaluate the financial performance of individual properties.</p> <p>(b) Agree: There is already a financial reporting practice in place (i.e., the monthly Operating Budget Variance Report review).</p> <p>(c) Agree – Staff continually monitor the rental market and have access to the Toronto Real Estate Board (TREB), Broker Websites and Marsh Real Net for market data / statistics. Staff will also ensure that all leases are negotiated at fair market value and will ensure that evidence of such reviews will be on file.</p>

**Management Response to the Auditor General’s
Review of the Administration of Leases on City-owned Property**

Recommendation	Management Response
<p>5. The City Manager take appropriate steps to implement the lease management function of the SAP Real Estate Module for all City leases, including those administered by the Parks, Forestry and Recreation Division. Unless there are compelling reasons to the contrary, the future development of alternative management information systems be discontinued.</p>	<p>Agree: We concur that all leases should reside in a single corporate system. It is anticipated that the SAP Real Estate module will be implemented in F&RE by April of 2007.</p> <p>PF&R are using the ACCESS database as an interim measure until the pilot for SAP Real Estate module, managed by F&RE is complete, at which time, PF&R intend to migrate to the SAP Real Estate module.</p>
<p>6. The City Manager take steps to:</p> <p>(a) review the status of all City lease agreements in order to ensure that every agreement is current. Immediate action be taken to finalize all expired leases; and</p> <p>(b) ensure that the SAP property management module currently being developed includes a facility to identify lease expiry dates well in advance of the actual expiry date so that expiring leases are identified and renewed on a timely basis.</p>	<p>(a) Agree: We support the recommendation of ensuring that leases are renewed on a timely basis. Divisions will review the status of all lease agreements and will take action to finalize all expired contracts as soon as possible.</p> <p>It should be noted that there are legitimate reasons as to why some leases are not renewed immediately following expiry. Many of the leases are complex in nature, involving changes to terms and conditions, which require lengthy negotiation processes.</p> <p>In addition, a number of legacy agreements were inherited from previous municipalities, and divisions have been working with Legal Services and the City Clerk’s office in updating these agreements.</p> <p>(b) Agree: The SAP Real Estate module will accommodate the identification of lease expiry dates. The system will be implemented in April of 2007.</p>

**Management Response to the Auditor General’s
Review of the Administration of Leases on City-owned Property**

Recommendation	Management Response
<p>7. The City Manager direct that a complete review of all lease agreements be initiated in order to ensure that all tenants are paying rent in accordance with specific provisions in lease agreements. Where lease payments are less than contractual amounts, efforts be made, in consultation with City Legal, to recover underpayments. A formal ongoing reporting process be established to ensure that appropriate lease payments are made on a timely basis.</p>	<p>Agree: We concur that all tenants should be paying rents in accordance with whatever signed lease agreement is in place.</p> <p>Accounts Receivable staff in Finance set up the recurring billing which is based on the lease agreement. Tenant accounts are debited with the invoice amount on the due date. In case of non-payments, follow up letters are sent to the tenants and if required, the matter is referred to Legal and/or to Collection Agencies.</p> <p>In addition, staff has implemented a monthly Status Review program for tracking underpayments or arrears (accounts receivables) in 2006.</p>
<p>8. The City Manager, in consultation with City Legal, direct that a policies and procedures manual for the administration of the leasing of all City-owned property be developed.</p>	<p>Agree: We agree that a policies and procedures manual would be beneficial. Leasing staff have access to lease management procedures which are available in easy to follow “flow charts” for residential and commercial tenancies. This will be the basis of any future manual to be prepared in the fall of 2006. The current procedures will be tailored to be consistent with the SAP design.</p> <p>In addition, ensuring the information is available in an electronic format on the City’s internal web site would also be helpful and provide easy access.</p>

**Management Response to the Auditor General’s
Review of the Administration of Leases on City-owned Property**

Recommendation	Management Response
<p>9. City Manager:</p> <p>(a) establish a formal lease compliance program in order to ensure that tenants are in compliance with key operational provisions contained within lease agreements; and</p> <p>(b) occurrences of non-compliance identified during property inspections be followed up on a timely basis and appropriately documented.</p>	<p>(a) Agree: We agree with the concept of establishing a formal lease compliance program and will assess the resources required to implement the recommendation.</p> <p>Presently F&RE has over 700 leases under its management while PF&R manage 338 leases. An annual review of lease compliance would require dedicated full-time staff to complete the review in one year. Pending provision of new resources a formal lease compliance program will be established.</p> <p>(b) Agree: As per (a) above, this could be implemented along with the annual review.</p>
<p>10. The City Manager ensure that up-to-date and adequate insurance coverage for all properties leased by the City is obtained. Evidence of insurance coverage be included in all lease files.</p>	<p>Agree: Staff will ensure that all commercial tenants provide updated insurance certificates in accordance with the lease provisions. Staff have begun an insurance tracking program in 2006 to ensure that expired certificates are replaced. Tenants are regularly contacted to replace their expired certificates with the new ones, once received; they are included in the lease files.</p>

**Management Response to the Auditor General’s
Review of the Administration of Leases on City-owned Property**

Recommendation	Management Response
<p>11. The City Manager ensure that, wherever possible, lease amounts are established through an independent valuation process such as the use of an appraisal process or through competitive bids. Evidence of such a process be documented and retained in lease files.</p>	<p>Agree: Existing procedures for a new lease or a renewal of the existing lease requires that a market rent evaluation be performed. This is normally done through a market appraisal or through competitive bids (i.e., issuance of a Request for Proposal).</p> <p>In situations where the cost of an appraisal is not justified, Property Officers and Revenue Supervisors undertake their own market rent valuation. In future, evidence of this process will be included in all lease files.</p>
<p>12. The City Manager ensure that all vacant City properties available for lease are identified. A proactive process be initiated to ensure that all such properties are marketed on a timely basis.</p>	<p>Agree: F&RE newly hired Revenue Supervisors are formulating a listing of all vacant City properties available for lease. A marketing plan will be developed and reviewed in a timely basis.</p>
<p>13. The City Manager review the capacity of current in-house leasing staff to deliver an effective leasing program, and based on this review assess whether there is a financial and operational advantage to assigning the administration of the leasing of City-owned property in whole or in part to an outside property management company. Detailed cost benefit analyses be an integral part of this evaluation.</p>	<p>Agree: The leasing management review will include an assessment of the appropriate level of resources necessary to manage and operate an effective leasing program.</p> <p>Recognizing existing resource limitations, we will also investigate alternative administrative systems.</p>

**Management Response to the Auditor General’s
Review of the Administration of Leases on City-owned Property**

Recommendation	Management Response
<p>14. The City Manager ensure that:</p> <p>(a) the inventory of below-market rent leases for City-owned properties is accurate, up-to-date and complete; and</p> <p>(b) the below-market rent policy addresses tenants who receive below-market rent for land or who have purchase of service agreements with the City.</p>	<p>(a) Agree: A list was produced in 2005 and it will be revised and updated on an ongoing basis in the SAP Real Estate module.</p> <p>(b) Agree:</p> <p>At the moment, there is no policy that governs the allocation of space to Purchase of Service (POS) organizations. As stated in the report titled “Phase One Implementation of the Policy on City-Owned Space Provided at Below-Market Rent (All Wards)” (Clause 23 of Report 4 of the Policy and Finance Committee), adopted by council in its meeting on April 12, 13 and 14, 2005, the City’s space allocation hierarchy established that POS organizations, who are contracted to deliver services on behalf of the City, should receive higher priority for City Space than other external organizations. These organizations were therefore exempt from eligibility review under the Below-Market Rent Policy.</p> <p>However, a number of issues necessitate a policy(s) to address the provision of City-owned space at below-market rent to POS Organizations.</p> <p>Staff from Social Development, Finance & Administration (SDF&A), Children’s Services, and Shelter Support and Housing Divisions will undertake to:</p> <ul style="list-style-type: none"> • review POS leases, • develop a specific policy(s) and implementation plan applicable to POS organisations, and • report to council.

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Recommendation	Management Response
	<p>At the moment there is no standardized approach to managing leases for vacant land. The Below-Market Rent Policy was designed to address the allocation of space in a building for the purpose of service delivery that supports City Objectives, and therefore leases for vacant land were not included in the review.</p> <p>A number of challenges exist in creating a standardized approach to managing leases for city-owned vacant land at below market rent. For example, the City’s inventory of vacant land includes underground tunnels and small strips of land that would be unusable except by the current lease-holders.</p> <p>SDF&A, PF&R, and F&RE will undertake to:</p> <ul style="list-style-type: none"> • review vacant land leases, • develop a specific policy(s) and implementation plan applicable to leases for City-owned vacant land, and • report to council.
<p>15. The City Manager ensure that:</p> <p>(a) a detailed financial assessment is conducted for all organizations being considered for below-market rent; and</p>	<p>(a) Agree: City Staff currently conduct a detailed financial assessment as part of the eligibility review process for the provision of City-owned space at Below-Market Rent. This process includes:</p> <ul style="list-style-type: none"> • a requirement that organizations submit a breakdown of various funding sources (identifying funding from other levels of government) • a financial audit analysis, and • an examination of unrestricted reserves.

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Recommendation	Management Response
<p>(b) the amount of any rent subsidy provided to organizations be based on the financial capacity of organizations to pay rent.</p>	<p>The financial assessment process is one of the risk-management tools used in order to assess organizational ability to deliver the services for which organizations are being provided with city-owned space at below-market rent.</p> <p>In consultation with Internal Audit, staff will review the current financial assessment process and report any recommended changes to Council.</p> <p>(b) Agree: A number of challenges exist in determining organizational ability to pay rent. These include:</p> <ul style="list-style-type: none"> • uncertainty about the market value rent for a number of City properties • the difficulty in planning for 5-10 year leases, when non-profit organization financial performance often fluctuates significantly from year to year <p>In order to assess organizational need for below-market rent, staff will develop guidelines for reviewing organizational assets.</p> <p>Upon the implementation of these policies, those organizations that are deemed financially capable of paying rent will be advised that the future provision of City-owned space at below-market rent will be discontinued.</p>

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Recommendation	Management Response
<p>16. The City Manager review the City’s eligibility criteria for the below-market rent policy with a view to making them more specific and measurable.</p>	<p>Eligibility criteria are the first step in the evaluation process. As with City funding programs, organizations must demonstrate that they meet all the eligibility criteria before they are permitted to occupy City-owned space at below-market rent. However, meeting the eligibility criteria does not guarantee that space will be provided.</p> <p>The eligibility criteria used in the evaluation of organizations who occupy City-owned space at below-market rent were approved by council in the report titled “Implementaion of the Policy for City-Owned Space Provided at Below-Market Rent”, Clause 14 embodied in Report No. 5 of the Policy and Finance Committee, on June 24, 25, and 26, 2003.</p> <p>Eight of the 44 organizations (18%) who were included in the eligibility review were determined ineligible based on the application of council-approved criteria.</p> <p>Staff will review criteria and indicators and report any recommended changes to council.</p>
<p>17. The City Manager establish priorities for providing below-market rent space. The City should allocate below-market space to organizations providing services which will most benefit its residents.</p>	<p>Agree. In addition to eligibility criteria, the evaluation process includes the application of Assessment Criteria to organizations that occupy City-owned space at below-market rent. Assessment Criteria allow applications to be prioritized according to council’s goals and objectives.</p> <p>Phase Two of the Implementation of the Policy for City-Owned Space Provided at Below-Market Rent includes the development of</p>

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Recommendation	Management Response
	<p>Assessment Criteria that will be used to prioritize the allocation of below-market space. City Staff have been working together to develop these criteria, and to establish an implementation plan for their application to organizations who currently occupy City-space at below-market rent. The progress on the Phase Two Implementation of the Policy for City-Owned Space Provided at Below Market Rent is the subject of a separate report submitted concurrently to the Policy and Finance Committee.</p>
<p>18. The City Manager ensure that:</p> <p>(a) Council reports seeking approval or renewal for leasing space at rates below-market contain the opportunity cost of providing the below-market space; and</p> <p>(b) the accounting of all grants in-kind be incorporated into the Corporate Grants Management Information System currently being developed for all City grants.</p>	<p>(a) Agree: F&RE to appraise market value to determine opportunity cost in each instance.</p> <p>SDF&A staff will provide F&RE with an outline indicating the timing for information requests regarding the opportunity costs of providing below-market space for inclusion in annual allocations reports.</p> <p>(b) The Corporate Grants Information System (CGIS) is currently in a pilot phase, and will be operational this year for one City Funding Program. In the coming years, the system will expand to include additional City funding programs.</p> <p>Staff will review CGIS functionality to determine how to include either program information on below-market leases, or more specific information on organizations occupying space at below-market rent.</p>

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Recommendation	Management Response
<p>19. The City Manager ensure that eligibility reviews conducted for below-market tenants include, where practical, a site visit and a review of other required documentation such as the lease agreement and financial statements. Evidence of completion of the eligibility review, including copies of documentation, should be retained in the lease file.</p>	<p>Agree. The eligibility review for organizations who occupy city-owned space at below-market rent has the following components:</p> <ul style="list-style-type: none"> • Site Visit • Eligibility Review • Review of financial information <p>Documentation also includes application information, eligibility checklists, audited financial statements, and the organization’s letters patent.</p> <p>SDF&A will</p> <ul style="list-style-type: none"> • continue to work with PF&R and Economic Development Culture & Tourism to ensure that this process is followed for all Below-market rent properties; and • coordinate with F&RE to ensure that copies of all this documentation are available in the lease file.
<p>20. Deputy City Manager and Chief Financial Officer upgrade the SAP financial information system to automatically produce standard collection reminder letters as soon as possible. When this functionality is implemented, all City Divisions responsible for the billing and collection of accounts receivable be required to use it to create timely reminder notices for all overdue accounts and such notices be sent out on a regular basis.</p>	<p>Agree: The functionality to automatically produce standard collection reminder letters is not currently available, but is intended to be introduced later this year. This functionality will be in place with the implementation of the SAP Real Estate leasing module in April of 2007.</p>

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Recommendation	Management Response
<p>21. The Deputy City Manager and Chief Financial Officer, in consultation with City Legal, require that all new tenants be mandated to participate in the pre-authorized payment program or provide post dated cheques or rental deposits in advance as a means of collecting rental income on a timely basis.</p>	<p>Agree: We agree that requiring tenants to participate in the pre-authorized payment program would facilitate the timely collection of rental income. F&RE and PF&R will work with Accounting Services and City Legal to assess the feasibility and legal implications pertaining to the implementation of this recommendation.</p>
<p>22. The Deputy City Manager and Chief Financial Officer ensure that:</p> <ul style="list-style-type: none"> (a) all revenue from existing leases containing provisions for “additional rent” are reviewed to ensure that all rental income is accounted for correctly; (b) all revenue from future leases, including “additional rent”, is accounted for appropriately and recorded as revenue and accounts receivable in the SAP Financial Information System when earned; and (c) all write-offs of outstanding receivables greater than \$10,000, irrespective of whether or not they have been accounted for in the City’s records, be approved by City Council. 	<ul style="list-style-type: none"> (a) Agree – that additional revenue should be recorded when the amount can be reasonably estimated. (b) Agree: F&RE to work with Accounting Services to develop an appropriate installment program to recover additional rent. (c) Agree – that failure to record revenue and the related receivable does not allow exceptions to be made to the write off requirements under the City’s Financial Control By-law.

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Recommendation	Management Response
<p>23. City Manager, in consultation with City Legal, clarify the legal concerns pertaining to the imposition of late payment charges on outstanding accounts and where possible such charges be imposed as soon as possible.</p>	<p>Agree: A by-law has been developed and approved by Council, providing the City with the authority to apply late payment charges to overdue accounts. Staff will work with City Legal to explore the applicability of the late payment charges by-law to leases, as well as other methods to impose such charges in leasing arrangements.</p>
<p>24. The City Manager ensure that prior to renewing any lease agreement direction be sought from City Legal in order to ensure that there is compliance with any lease renewal provisions and in addition all outstanding receivables are collected prior to the commencement of negotiation of any lease renewal.</p>	<p>Agree: Divisions will work with City Legal to address outstanding receivables prior to any lease renewal.</p>
<p>25. City Council direct that this report be forwarded to the City’s major Agencies, Boards and Commissions in order to ensure that concerns, issues and recommendations raised in this report are considered and addressed where appropriate.</p>	<p>Agree.</p>