AUDITOR GENERAL'S REPORT

Enhance Focus on Lease Administration of City-owned Properties

June 28, 2018

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TORONTO

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EXECUTIVE SUMMARY

Audit was added to the 2017 Work Plan as a result of concerns with Union Station leasing

The Auditor General's June 2017 report entitled: *"Real Estate Services Division: Restore Focus on Union Station Leasing"* identified that the City was not billing or collecting certain rents and operating costs from tenants at Union Station. This finding caused concern about other leases. The Auditor General amended her 2017 Audit Work Plan to include an audit of lease administration of City-owned properties.

City generates over $50 million in leasing revenues annually

The City generates over $50 million in leasing revenues (rents and recoveries) annually. Historically, responsibility for the day-to-day management of lease agreements has resided with multiple divisions. As the City moves forward with a centralized service delivery model for real estate, it is expected that leasing activities across the City will be consolidated.

Our audit reviewed leases[1] managed by the Real Estate Services and the Parks, Forestry and Recreation Divisions.

Audit objective

The objective of this audit was to assess management's practices for efficiently and effectively administering lease agreements. As part of the audit, we wanted to answer the following questions:

- Are leasing revenues being maximized? (or in the case of Community Space Tenancies, is the City cost-neutral?)
- Are rents and operating cost recoveries being billed and collected on a timely basis?
- Is there compliance with agreements?

The systemic deficiencies in basic lease administration practices we observed during this audit are not new.

[1] Where the term "leases" or "leasing" is used throughout the report, it should be interpreted to be applicable to all occupancy arrangements on City-owned properties including leases, licences, construction agreements, and below market rent / community space tenancies.

Issues raised in Auditor General's 2006 review of lease administration

In 2006, the Auditor General conducted a "*Review of the Administration of Leases on City-owned Property*". The 2006 audit identified a number of issues including:

- Leasing policies and procedures should be established
- Market rents should be independently determined
- Execution and timely renewal of lease agreements requires improvement
- Provisions contained in certain lease agreements are not being addressed by management
- An accurate and complete inventory of lease agreements does not exist
- No formal plan exists to identify and lease vacant property
- Option of assigning the management of the City's leasing portfolio to an external party should be considered.

The 25 recommendations made in 2006 were subsequently addressed by management. Despite this, many of the issues identified in this audit are the same as those raised in 2006.

The 2006 report is available at:
https://www.toronto.ca/legdocs/2006/agendas/committees/au/au060920/it001.pdf

Prior Auditor General reports with relevant findings

Furthermore, since 2006, a number of other reports by the Auditor General have identified issues relevant to effective lease administration, including:

- 2017 audit of water billings identified properties that did not have a water meter installed, or were not billed for water consumption
- 2016 audit of property tax billings identified potential revenue leakage due to incorrect property tax classifications
- 2011 concession agreements review highlighted the need for robust processes to ensure the City was collecting all entitled snack bar and concession revenues and property taxes.

All of these audits highlighted that the City was not fully collecting applicable rents and recoveries[2] from leased properties.

Need for an enhanced focus on lease administration

This current audit highlights the need for an enhanced focus on lease administration including:

A. Effective monitoring and oversight to ensure lease revenues are maximized

B. Immediate action to address billing and collection of additional rents and recoveries

C. A strategic and coordinated approach to leasing, effective performance measures, standardized City-wide policies and procedures, and appropriate resourcing of the leasing function.

Limitations to our audit

Our findings and conclusions were based on the information available at the time the audit was completed. In some cases:

- management could not locate the information we requested
- staff turnover limited management's ability to answer our questions
- lease data in the City's financial system was not accurate or up-to-date.

Audit findings should be considered as part of the City-wide Real Estate Transformation

The implementation of the City-wide Real Estate Transformation, which began in May 2017, will impact roles and responsibilities for leasing. A first step in implementing the new centralized model was the consolidation of leasing activities within City divisions which began in November 2017 with changes to the delegated authorities.

In moving forward, Real Estate Services has also completed an internal process review to map out the key processes (as-is process), identify gaps and necessary actions, both tactically and strategically. The development of a City-wide leasing strategy is another key activity of the new model.

Significant milestones with respect to the new model and mandate are further described in the Background section.

[2] Recoveries may vary from agreement to agreement but generally would include a tenant's proportionate share of building operating expenses, utilities, property taxes, and in some cases, capital repair costs.

We recognize that under the transformation, policy will evolve and the current processes we reviewed will likely change. Our audit findings and recommendations should be considered as the City moves forward with developing its leasing strategy under the new centralized model.

A. Maximize Lease Revenues from City-owned Properties

Sufficient evidence to demonstrate that rents reflected market rates is not always retained

Documentation supporting the negotiated rents in lease agreements could not always be located. In some agreements we reviewed, staff could not demonstrate that rents reflected market rates because records such as appraisals, financial analyses, or comparable market rates were not retained. We did note better record retention in support of more recent agreements.

In one example, the City accepted a one-time pre-payment for the equivalent of 60 years of basic rent. The 2006 staff report to City Council indicates that this transaction was reflective of market value. However, we are unable to verify that the negotiated rents reflected market rates because the supporting documentation and analysis (including assumptions) was not retained or could not be located.

Factors impacting negotiated rents should be well documented

As management was unable to provide documents to substantiate the rent determination, we estimated the value of the transaction using the terms for an existing lease on the site as reported to City Council at the same time in 2006. We estimated the City could have generated between $2 million and $4 million more in rents just by retaining control of the existing lease on a portion of the site rather than assigning the lease for a one-time pre-payment of rents.

The current market value of the site has increased significantly in the ten years since this long-term transaction was executed. Development in the surrounding area, as well as improvements made to the site itself as a result of the agreement have contributed to the increased market rates. The City will not receive any further basic rent revenues as a result of these market changes for the remaining term of the lease.

Management advised that other terms and conditions of the agreement were of value to the City, including capital improvements to the base building, and would have impacted the negotiated rents. The arrangement also supported the City's non-financial program objectives for the heritage site. However, management was unable to provide documentation or analysis to quantify the value of the investment or its impact on negotiated rents.

We appreciate the complexity of real estate negotiations. However, going forward, management should ensure that sufficient documentation is retained to demonstrate that the negotiated rents reflect market rates. Where other factors impact the negotiated rents, these reasons should be well documented and the analysis or source documents used to substantiate the impact on value should be retained.

City is not ensuring all negotiated capital improvements are received

In addition, some agreements contain clauses where the occupant agrees to fund and provide capital improvements to enhance or renovate the property leased from the City. In some cases, capital improvements were completed but staff did not verify the extent and value of work performed. In other cases, the required work was not completed. Out of the $14.8 million in capital commitments related to agreements we reviewed, documentation was not available to demonstrate that the City received the full value of approximately $14.1 million of the negotiated improvements. Agreement terms need to more clearly describe the expected nature of improvements. Better tracking and monitoring controls should also be implemented to ensure that commitments for capital improvements are fulfilled.

Rent should reflect market rates throughout the term of the agreement

While the rent set out in a longer-term agreement may represent the market rate when the agreement was signed, the value of the occupied property may change over time. On longer-term agreements, the City should include rent escalation clauses and perform periodic market rent reviews to ensure that the rent the City collects, reflects market rates throughout the term of the agreement. Although we recognize that there may be exceptions to the norm, these clauses are common in the real estate industry as they aim to balance both landlord and tenant risks.

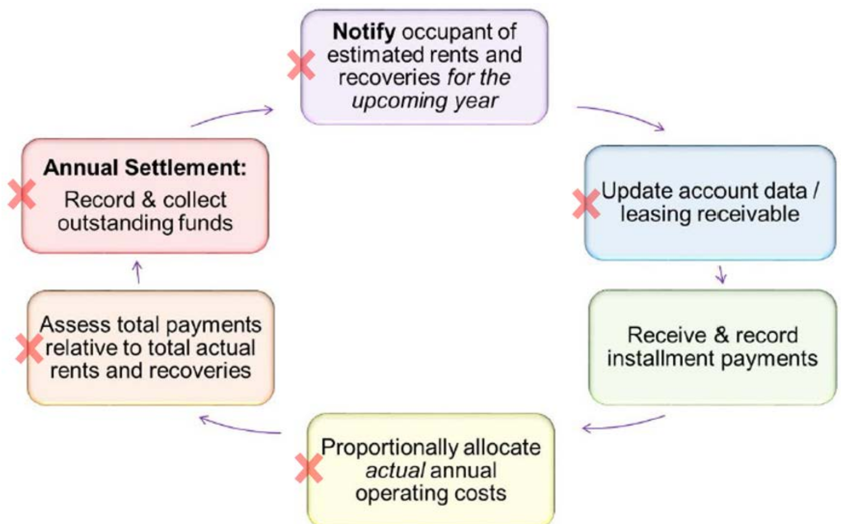
Expired agreements need to be promptly addressed

The City should also ensure that expired agreements are addressed on a timely basis, and that overhold rents be applied, where applicable. The City loses out on an opportunity for increased rent revenues where agreements are not renewed at market rates in a timely manner. For expired leases we reviewed, we estimate that the City could potentially have generated additional basic rents of $931,000, from the time the agreements expired to December 31, 2017, had they been promptly renewed.

B. Ensure Timely Billing and Collection of Additional Rents and Recoveries

Expected lease administration activities are not always consistently performed in a timely manner

We expected that basic lease administration activities would be consistently performed in a timely manner, on an annual basis.



X – *Activities not consistently performed*

Agreements specify additional rents and recoveries the City can collect

Certain agreements include clauses where the City is entitled to collect additional rents and recoveries such as:

- a percentage of the tenant's revenue or profit (commonly referred to as percentage rent)
- a proportionate share of utilities (such as water, hydro, and gas), building operating costs (such as security, custodial, repairs), and property taxes, where applicable.

Percentage rents, utility costs, property taxes, and other eligible expenses were not always billed and collected

In our review of a sample of 45 occupancies[3], we identified 22 properties where additional rents and recoveries were not billed and collected. For example, one commercial tenant was not billed $632,000 for hydro since 2006. Management is currently working with Legal Services staff to recover the full amount from the tenant. Additional examples are detailed in the report. There was one occupancy in our sample that was not governed by an agreement.

Year-end settlements of actual recoverable operating costs are not always performed

We also noted that annual estimates and year-end settlements of actual recoverable operating costs were not performed for a number of leases on a timely basis.

Over $4.5 million in rents and recoveries for prior periods went unbilled on files we reviewed

We were unable to determine the full amount of unbilled additional rents and recoveries related to agreements included in our sample. However, in nine locations in our sample, we identified at least $4.5 million that have not been billed for prior periods (in some cases, dating back to 2002), of which at least $728,000 relates to 2017. We recognize that 65 per cent of this amount pertains to below market rent tenants. However, as reflected in the agreements we reviewed, it is expected that these below market tenancies be cost-neutral to the City (i.e. tenant pays nominal rent but is responsible for paying their share of building operating costs).

It is likely that additional amounts have gone unbilled over time

Given the systemic nature of our findings, it is likely that additional amounts have gone unbilled over time in the leases we did not review. In this context, it is important that management take prompt action to review all of its leases and address the concerns we identified. It is our view that the City's failure to perform fundamental lease administration activities has resulted in revenues that are lost to the City.

[3] Our sample covers 40 per cent of 2017 leasing revenues (excluding Union Station leases)

C. The New Centralized Service Delivery Model Presents an Opportunity to Enhance Lease Administration

Enhance lease administration as part of the City-wide Real Estate Transformation

In line with the new centralized real estate service delivery model, this is the opportune time to affirm Real Estate Services as the central authority going forward to take the necessary actions to:

- set out a coordinated City-wide leasing strategy to ensure optimal occupancy of City-owned properties
- define expected outcomes and develop measures to evaluate performance of the complete portfolio of leasable properties
- establish and implement robust policies and procedures that should be applied City-wide to efficiently and effectively manage leasing activities including consideration for charging an administrative fee based on industry practice
- determine an appropriate resourcing strategy to ensure sufficient resources to oversee effective and consistent lease administration going forward.

Management recognizes and is prioritizing the need to improve lease administration processes.

Management action is already underway

There is new leadership of the portfolio and this audit will provide a roadmap to support leadership going forward. In early 2018, as a result of the expanded City-wide scope and mandate for Real Estate Services, the Division adopted a new organizational structure. This re-organization includes a new property management and lease administration function to focus on financial stewardship.

Real Estate Services is developing a process to undergo annual reviews of the lease portfolio in order to ensure the Division is:

- adequately managing the lease administration process during the lease term;
- maintaining an updated status of accounts; and
- ensuring tenants and landlords are in compliance with their obligations as outlined in the lease agreements.

Conclusion

This report raises fundamental concerns in how the City manages its leasing portfolio.

19 recommendations to enhance focus on lease administration

The 19 recommendations contained in this report will help ensure that the City meets its program and strategic objectives, maximizes rent revenues, and recovers operating costs. Implementation of the recommendations will improve how the City manages its leasing agreements going forward as well as how the City collects its rental income.

The systemic and recurrent nature of the issues identified indicate that it is likely that additional concerns exist in the leases which we have not reviewed. Therefore, it is important that management address the findings in this report to prevent the loss of leasing revenues.

Relevance to other City divisions, agencies, and corporations

The findings from this audit may be relevant to other City divisions, agencies and corporations which are responsible for leasing out City-owned properties.

Less significant matters separately communicated to management

The Auditor General will issue a separate letter to management detailing other less significant issues that came to our attention during the audit. In addition, work on certain matters arising from this audit is ongoing and may be reported upon separately in the future.

We express our appreciation for the co-operation and assistance we received from management and staff of:

- Real Estate Services Division
- Parks, Forestry and Recreation Division
- Business Management Unit of the Office of the Deputy City Manager (Internal Services)
- Environment and Energy Division
- Legal Services Division
- Social Development, Finance and Administration Division
- Revenue Services Division
- Accounting Services Division
- Toronto Hydro

BACKGROUND

Leasing of City-owned properties is quite varied in nature

Leasing of City-owned properties is quite varied in nature and includes commercial, residential, heritage, below-market rent and vacant land.

Leases[4] originate in a number of ways:

- The City inherited a variety of lease arrangements as a result of amalgamation
- The City publicly markets opportunities to lease out available space
- The City receives unsolicited expressions of interest to use space on City-owned property.

In some cases, in order to achieve a policy, program or service objective, the City looks to transfer the upfront cost of capital investment or improvements of a property to a private partner in return for a long-term lease.

All leases are approved by City Council

City Council approves all leases directly or through its delegation of authority to the Deputy City Manager (Internal Corporate Services).

Day-to-day leasing management resides with multiple divisions

The City generated approximately $53 million in leasing revenue in 2017. Responsibility for the day-to-day management of lease agreements resides with multiple divisions.

- Real Estate Services' (RES) portfolio includes more than 900 leases that generated over $45 million in rental revenues in 2017
- Parks, Forestry and Recreation (PF&R) manages approximately 170 leases that generated nearly $6 million in rental revenues in 2017
- Other City divisions generated over $2 million in rental revenues in 2017.

[4] Where the term "leases" or "leasing" is used throughout the report, it should be interpreted to be applicable to all occupancy arrangements on City-owned properties including leases, licences, construction agreements, and below market rent / community space tenancies.

A breakdown of the start date[5] of leases managed by RES and PF&R is included below:

Date lease originated	Number of leases	Revenues from leases in 2017
Pre-amalgamation	368	$24 million
1998 to 2007	329	$15 million
2007 to 2012	175	$6 million
After 2012	198	$6 million

Certain community organizations occupy space at nominal rent

The City's leasing portfolio includes space City Council has approved for use by community organizations at nominal rent (i.e. below market rent)[6]. There are approximately 100 agreements currently in place with community organizations that have been granted the use of space on City-owned property under the old Below Market Rent policy or through historical or special lease arrangements.

Centralized Real Estate Service Delivery Model

A new City-wide approach to managing the City's real estate portfolio

In July 2016, City Council approved, in principle, the direction to move to a centralized service delivery model for real estate[7]. The staff reports to Council indicated that the state of real estate management at the City was made up of an entangled system of governance and service delivery. There were many City entities (over 24 divisions, agencies and corporations) involved in real estate activities with varying governance structures, program objectives, investment plans, processes, data and technology, skill and expertise. When coupled with increasing real estate demands, this posed considerable challenges to achieving desired city-building outcomes.

[5] The start dates of leases in the City's financial system may reflect the date of the original agreement rather than the start date of the most current renewal, extension, or amending agreement with the tenant.
[6] These tenants are ordinarily required to pay for occupancy costs such as heat, hydro, water, and their share of operating costs. These arrangements are expected to result in a cost-neutral impact to the City.
[7] The staff reports on the City-Wide Real Estate Transformation are available at:
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2016.EX16.4
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2017.EX25.9

City-wide real estate review identified key areas of opportunity

In partnership with an external consultant, the City undertook a review of the real estate service delivery model. The review identified key areas of opportunity for improvement to the City's real estate service delivery including:

- the creation of a new focused mandate
- clear delineation of key functions including strategic planning, development, transactions (including leasing)
- the creation of a client relationship management function.

Consolidation of leasing activities began in November 2017

The new model was approved by City Council in May 2017, and implementation began soon after. Management advised that a first step in implementing the new centralized model was the consolidation of leasing activities within City divisions which began in November 2017.

In May 2017, Real Estate Services initiated an internal lease administration review performed by the Business Management Unit of the Deputy City Manager's (Internal Services) Office. The results were communicated in February 2018. Management is reviewing improvement opportunities identified in that review.

Milestones with respect to the new model and mandate

Management advised that significant milestones, to date, with respect to the new model and mandate include:

- Q1, 2017: Commencement of process reviews
- Q2, 2017: Commencement of the implementation of a consolidated model
- Q4, 2017: Centralization of authorities and changes to the Municipal Code
- Q1, 2018: Organizational restructure of RES, with alignment around key functions including lease transactions and administration
- Q2, 2018: Collaboration of PF&R and RES teams to define the separation of program versus real estate activities, define these in a service level agreement document and transition the real estate activities to RES
- Formation of a dedicated team in Q2 2018 to drive the implementation of the improvement opportunities identified throughout the lease administration review, and to address the audit findings outlined in this report.

AUDIT RESULTS

This section of the report contains the findings from our audit work followed by specific recommendations.

A. MAXIMIZING LEASE REVENUES

A key objective is to maximize lease revenues

One of the key objectives of Real Estate Services is to maximize lease revenues by regularly reviewing the City's building portfolio and current market rates and negotiating optimal leasing arrangements. This is balanced with its priority to assist other City divisions in facilitating their programs and services.

Effective monitoring and oversight is needed to ensure lease revenues are maximized

There is a need to improve monitoring and management oversight of leases, from negotiation through to expiry, in order to ensure lease revenues are maximized. In particular, during this audit we found:

1. Negotiated rents may not always be based on market rates
2. Insufficient evidence that occupants have fulfilled their commitments for capital improvements
3. Rent increases and rent reviews are not always taking place
4. Lease agreements expire and are not always addressed in a timely manner

Program objectives are also considered when granting leases

There are circumstances where program objectives are prioritized when granting leases and licenses. For example, Parks, Forestry and Recreation consider program objectives of enhancing the park experience for visitors.

Additionally, the City may choose to transfer the upfront cost of capital investment or improvements of a property to a private partner in return for a long-term lease at below market rates.

The City's policy objectives also support granting community space tenancies at nominal rent to organizations that deliver community and cultural services to residents and further the City's strategic objectives.

A.1. Negotiated Rents on Commercial Leases Should Reflect Market Rates

Negotiated rents may not reflect market rates

Staff could not always demonstrate that negotiated rents were based on market rates at the time the agreements were executed, and for longer-term agreements, throughout the term of the lease.

Market analysis supporting negotiated rents was not always retained

In nearly half of the commercial agreements we reviewed (11 out of 24), documents demonstrating adequate due diligence to substantiate negotiated rents were not retained. In particular, supporting documents including comparable market rates, external or internal appraisals, and financial analyses were not retained. We did note better retention of documents for agreements entered into in the past three years.

In one example, the City entered into a 60-year head lease agreement for 75,000 square feet of commercial space. The Head Tenant pre-paid 60 years' worth of basic rent in 2009, equivalent to $4.4 million. By the end of 2009, the City had used up the one-time pre-payment of future rents to fund a portion of capital work at this property. The City is not entitled to any further basic rent revenues. Additional revenues derived from this and other agreements on this property are insufficient to offset the City's ongoing operating and capital requirements related to the portion of the property it retains responsibility for.

We are unable to verify that negotiated rents reflect market rates

The 2006 staff report to City Council indicates that the transaction was reflective of market value. During negotiations, an external consultant engaged to review the arrangement indicated that the value of the transaction was not unreasonable[8]. However, we are unable to verify that the negotiated rents reflect market rates because the supporting due diligence documentation and financial analysis performed by staff at the time of the transaction was not retained.

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[8] The external consultant's conclusions were based on information provided by City staff and the other party. This information was believed to be reliable but was not audited or otherwise verified by the consultant.

Documents to substantiate the rent determination were not retained

As management was unable to provide documents to substantiate the rent determination, we analyzed the value of the transaction using the terms for an existing lease on the site as reported to City Council at the same time in 2006. We estimated the City could have generated between $2 million and $4 million more in rents just by retaining control of the existing lease on a portion of the site rather than assigning the lease for a one-time pre-payment of rents. The current market value of the site has increased significantly in the ten years since this long-term transaction was executed.

Market value has increased over time

Preliminary market research by Real Estate Services indicates that market rents for similar retail / commercial spaces in the vicinity are now in the range of five to seven times higher than the rates included in the assigned lease. Development in the surrounding area, as well as improvements made to the site itself as a result of the agreement, have contributed to the increased market rates. The City will not receive any further basic rent revenues as a result of these market changes for the remaining term of the lease.

Arrangements consider the City's financial and non-financial program objectives

Management advised that other terms and conditions of the agreement were of value to the City, including capital improvements to the base building, and would have impacted the negotiated rents. The arrangement also supported the City's non-financial program objectives for the heritage site. However, management was unable to provide documentation or analysis to quantify the value of the investment or the extent of the impact on negotiated rents.

In addition, as part of the head lease, the City continues to directly receive percentage rents associated with the assigned lease. However, prior to assigning the lease, the base on which percentage rent was to be applied was amended to exclude the tenant's largest revenue stream. In reporting these amendments to City Council, staff noted "*Certain revisions to the percentage terms will see immediate percentage rent payments*". As a result of this amendment, instead of collecting approximately $850,000 in percentage rents over the last five years (between 2012 and 2016), the City has collected $nil. No documentation was retained to reflect any sensitivity analysis to support this amendment.

Documentation should be retained to demonstrate that the City is maximizing revenues

Going forward, management should ensure that sufficient documentation is retained to demonstrate that the negotiated rents reflect market rates. Where other factors impact the negotiated rents, these reasons should be well documented and the analysis or source documents used to substantiate the impact on value should be retained.

Standard operating procedures do not clearly specify the documentation, analysis, and/or market rate information that should be retained. Such documentation is needed to demonstrate that the City is negotiating optimal leasing arrangements. In the 2006 lease administration audit, a similar issue was identified. At the time, the Auditor General recommended that lease amounts be established through an independent valuation process (i.e. use of an appraisal or through competitive bids).

Recommendation:

1. City Council request the Director, Real Estate Services, in consultation with all City divisions that negotiate and administer leases, to develop a standard City-wide policy to ensure negotiated rents are consistent with market conditions at the time agreements are executed; and, that appropriate supporting research and financial analysis is retained.

A.2. Commitments of Capital Improvements to City Assets Should Be Tracked

Some agreements include commitments to improve City-owned property

Some lease agreements contain clauses where the occupant agrees to fund and provide capital improvements to enhance or renovate the occupied property. However, the agreements do not always clearly specify in sufficient detail, the nature of the investment or the type of work to be completed.

Capital improvements are factored into negotiating rents

Capital Improvements Impact Negotiated Rents

Management advised that the purported value of capital improvements to be provided by the tenant is a factor considered when negotiating the amount of rent to be charged. However, on the majority of files we reviewed, there is no documentation to indicate how the in-kind capital contributions impacted negotiated rents.

Documents not retained to support why negotiated rent is lower than market rates

In one lease we reviewed, staff did not retain documents to support the basis for the negotiated rent, or the value of capital improvements received from the tenant. In 2006, City Council approved a 20-year lease agreement for a 23,000 square foot building located on parkland in downtown Toronto. The tenant is required to pay the greater of $25,000 (annually adjusted for CPI[9]) or a percentage of gross sales. Over the past five years, the average annual basic rent (based on unaudited sales figures) was around $40,500.

In 2011, Real Estate Services commissioned an independent appraisal for this property. The report indicated that the current lease rate was lower than the market rate of $20 per square foot. This is equivalent to a difference of approximately $420,000 in annual base rent.

Over the 20-year term of the lease, we estimate that the actual rent revenue under the current terms of the lease may be up to $8.4 million less than what could have been generated at market rates. Conservatively, even if the City could have negotiated rents at half the $20 per square foot market rate, it could have generated nearly $4 million more.

Capital improvements which may have impacted negotiated rents were not included in any formally executed agreements

This difference in base rent charged compared to the market rates may be offset in part by the capital investment the tenant was to make to improve the City-owned facility. According to the 2006 staff report to City Council, in addition to paying basic rent, this tenant was to invest approximately $3.5 million in capital improvements to the City-owned facility. However, this commitment was not included in any formally executed agreement and there is no documentation of the value of the actual capital improvements made by the tenant.

[9] Consumer Price Index (CPI)

Insufficient Evidence that Tenant Capital Improvements are Obtained in Full

Occupants are not always fulfilling their commitments to make capital improvements

There is no process to track all agreements which contain capital improvement clauses and to ensure they are received. In addition to the previously identified example, during our audit we identified six other agreements that contained a clause for capital commitments by the occupant. In three of these cases, capital improvements were completed but staff did not verify the extent and value of work performed. In three other cases, work was not completed.

Insufficient evidence that $14.1 million in required capital improvements were received in full

In all, out of the $14.8 million in capital commitments related to agreements we reviewed, there was insufficient evidence that $14.1 million was received in full. The City did not receive $2.5 million in required capital improvements and documentation was not available to demonstrate the remaining $11.6 million in commitments were received in full.

For example, one agreement requires the occupant to invest $4.65 million in capital improvements and state-of-good repair projects within the property by the end of 2019. The agreement does not specify whether the investment should be towards improving City-owned assets or assets owned by the occupant that are also located on the property.

Staff do not know the value of capital improvements the City will retain

We found the occupant largely directed its capital investment towards improvements of equipment that they own. When the agreement expires, the equipment (and any improvements to them) would not be turned over to the City. Staff could not confirm the value of the capital improvements the City will retain at the expiry of the contract.

City is not ensuring all negotiated capital improvements have been received

Under a separate agreement, this occupant was also required to make $2.78 million in capital improvements to City-owned assets by the end of 2015. In early 2018, the occupant advised staff that approximately $1.75 million in improvements have been made to date. Staff have requested substantiation for these capital improvements. The occupant is still required to provide an additional $1 million in improvements to be in compliance with the agreement.

Process Needed to Monitor Tenant Commitments to Make Capital Improvements to Leased Out Property

Controls are needed to ensure that the City is satisfied with all capital improvements

All agreements that include commitments for capital improvements should specify in sufficient detail, the nature of the investment (i.e. type of work to be completed). This enables City staff to validate the actual capital improvement is sufficient to fulfill the commitment. Monitoring controls should be implemented to ensure that the City is satisfied with the timing, quality, nature and value of any such capital improvements.

The City should also establish a process for tracking all cash or in-kind commitments to improve City-owned assets. This process could include setting up a receivable (where applicable) until the commitment has been fulfilled.

Recommendation:

2. City Council request the Director, Real Estate Services, in consultation with all City divisions that administer leases, to develop and implement monitoring controls to ensure all commitments for capital improvements in current and future lease agreements are fulfilled. Such controls to include:

a. specifying in sufficient detail in formal agreements, the nature, expected value, and timing of capital work to be completed

b. logging or tracking all agreements and the related capital commitment

c. obtaining and retaining documentation, such as invoices, to support the value and nature of work completed.

A.3. Longer-Term Leases Should Include Periodic Market Rent Reviews and Rent Escalation Clauses

Over 85% of agreements in the lease portfolio are for periods greater than 5 years

Existing leases can range anywhere from months to significantly in excess of 20 years in duration. Based on data in the City's financial system:

Lease Duration	Number of Leases
No contract end date (e.g., perpetual leases)	192
Greater than 50 years	98
20 to 50 years	186
10 to 20 years	279
5 to 10 years	167
1 to 5 years	126
Less than 1 year	22

Market rates change over time

While the rent specified in a long-term agreement may represent the market rate when the agreement was signed, the market conditions may change over time. For example, commercial rents in Toronto have increased by between seven and twelve per cent over the last five years[10].

A number of longer-term leases are charged the same basic rents year-over-year

Therefore, we expected long-term lease arrangements to contain clauses to address changes to market rates over time. Although we recognize there may be exceptions to the norm, these clauses are common in the real estate industry as they aim to balance both landlord and tenant risks. However, we observed a number of commercial agreements where basic rent stayed the same year-over-year.

[10] Based on average lease rates for commercial/retail and office space as reported by Toronto Real Estate Board

Out of 22 longer-term commercial agreements we reviewed, we noted that there were:

- seven lease agreements that did not include clauses requiring periodic adjustment of rents based on market reviews
- three out of 14 lease agreements that included clauses for rent escalations but the required increases were not billed or collected
- three lease agreements that included clauses for market reviews. In one case, the required reviews were not performed.

City could have charged higher rents

Where rent increases or periodic market rent reviews are not always performed, the City may not be maximizing the full extent of rent revenues to which it is entitled.

For example, staff did not perform the two required rent reviews in a long-term agreement. The occupant paid the same $75,600 annual base rent for almost 12 years. In 2016, when an extension was granted, the terms were amended to increase the annual base rent to $110,000. This is approximately 45.5 per cent higher than the annual base rent charged over the previous 12 years. Had the required rent reviews been performed in 2006 and 2011, the City could have increased annual base rents and collected more revenues.

Existing system is not effectively used to prompt staff of upcoming rent reviews

Ongoing monitoring of the lease portfolio would have identified that action was needed on these agreements. Real Estate Services' standard operating procedures require monthly system-generated reports to be run to identify all agreements subject to upcoming rent increases or market rent reviews. Management advised that these reports are not being generated in accordance with divisional guidelines.

Recommendation:

3. City Council request the Director, Real Estate Services, in consultation with all City divisions that negotiate and administer leases, to:

a. establish standard City-wide lease terms that include rent escalations and/or periodic market rent reviews in longer-term lease agreements; and, where the terms are not applied, ensure justification for the exception is documented and reviewed by management

b. implement monitoring controls to ensure required rent increases or periodic market reviews are completed in a timely manner.

A.4. Address Agreements Approaching Expiry on a Timely Basis

Agreements go month-to-month after they expire

Most agreements contain clauses that provide for the continuity of occupancies on a month-to-month basis once the lease term has expired. This is often referred to as "overholding". When an agreement is in overhold, the expired terms and conditions remain in effect until a new agreement is signed. The need for timely renewal of lease agreements was identified in the 2006 lease administration audit and is an issue that continues to persist. The City should proactively ensure new negotiations are initiated before the expiry of any lease. Action is also needed to address existing expired agreements on a timely basis.

City loses rental revenue when agreements are not renewed at market rates in a timely manner

According to data provided by Real Estate Services, as at December 31, 2017, there were approximately 350 agreements that had expired. Some agreements have been in overhold for over 10 years. Management advised that Real Estate Services prioritizes agreements based on their potential value and years in overhold. For instance, management advised that nearly half of the expired agreements related to below market rent tenants or are nominal agreements. Management further advised that expired agreements that have significant value have been assigned to staff for review.

In 2017, approximately $12.5 million in basic rents and $5.5 million in additional rents and recoveries related to expired agreements. Forty per cent of all leasing revenues are generated from these expired leases. In many cases, occupants are allowed to continue to pay the same rent while in overhold. While the majority of these leases expired less than five years ago, some agreements have been in overhold for more than 10 years.

$931,000 in additional revenues could have been generated if the expired agreements we reviewed were promptly renewed

The City loses out on an opportunity for increased rent revenues where agreements are not renewed at market rates in a timely manner. For leases we reviewed that expired prior to 2017, we estimate that the City could potentially have generated additional basic rents of $931,000 from the time the agreements expired to December 31, 2017. Our estimate conservatively adjusts basic rents in line with inflation (using the Consumer Price Index).

City is not always charging rent at agreed overhold rates which can be a substantial amount

We noted some agreements contain provisions that require the tenant to pay rent at an amount substantially in excess of the rental rate at the end of the term (up to 200 per cent). This rate is applicable until a new agreement is signed. Even so, in the majority of agreements we reviewed that contained these terms, the City was not collecting the escalated overhold rents.

City has not billed and collected approximately $341,000 in rent applicable while tenant is overholding

For example, one expired agreement we reviewed contained a provision requiring the tenant to pay 200 per cent of the annual rent specified in the expired lease. The tenant has been overholding since September 2013. We noted that the overhold rate was never charged. So far, we estimate that the tenant has not been billed $341,000 for overhold rent since the lease expired. We also noted that currently, market rent for this property is approximately 93 per cent of the overhold rate that should have been charged.

In a review of 18 other expired leases (as at December 31, 2017), we identified one case where the City successfully billed and collected rent at an overhold rate of 150 per cent. In four other cases, the overhold rate was not being charged. We estimate that, for the period since these agreements expired (up to the end of 2017), the City has not billed and collected over $330,000 based on the rent applicable while the tenant is overholding. Where these agreements continue to be on overhold, the City is not billing over $20,850 on a monthly basis. Management advised that when the City does not get to the renewal on time, they are unable to enforce the overhold rate.

Recommendations:

4. City Council request the Director, Real Estate Services, in consultation with the City Solicitor, to review all leases currently in overhold to determine whether the City can and should retroactively bill and collect all rents owing in accordance with the overhold rate specified in the respective agreement.

5. City Council request the Director, Real Estate Services, in consultation with the City Solicitor, to establish criteria for determining when a month-to-month overhold rate should be included in new, extended, or amended lease agreements.

6. City Council request the Director, Real Estate Services to establish a process to ensure the lease management system is accurately set up to automatically alert staff to:

   a. agreements where negotiations for the next term should commence in order to prevent unnecessary overholding

   b. charge the appropriate overhold rate upon agreement expiry, where appropriate; and take action to address expired agreements in a timely manner.

B. BILLING AND COLLECTING RENTS AND RECOVERIES

Additional rents and recoveries are specified in agreements

Certain agreements include clauses where the City is entitled to collect the following additional rents and recoveries:

- a percentage of the tenant's revenue or profit (commonly referred to as percentage rent)

- a proportionate share of utilities (such as water, hydro, and gas), building operating costs (such as security, custodial, repairs), and property taxes, where applicable.

Real Estate Services does not currently have an accurate and complete tracking of which agreements require recovery of percentage rents, as well as, utilities, property taxes, and operating costs. Consequently, billing and collection of these rents and recoveries have not occurred in a systematic and consistent manner for a number of years.

22 properties where additional rents and recoveries were not billed and collected

In our review of a sample of 45 occupancies, we identified 21 properties where additional rents and recoveries were not billed and collected in accordance with agreements. There was also one occupancy not governed by any agreement. The City does not bill and collect rents and operating cost recoveries from this third-party occupant.

We also found that annual estimates and settlements of any amounts owing or due based on actual results, were not performed for a number of leases in Real Estate Services' portfolio on timely basis.

Over $4.5 million in rents and recoveries for prior periods went unbilled on files we reviewed

We were unable to determine the full amount of unbilled additional rents and recoveries related to agreements included in our sample. However, as summarized in Table 1, in nine locations in our sample, we identified $4.5 million in additional rents and recoveries that have not been billed for prior periods (in some cases, dating back to 2002), of which at least $728,000 relates to 2017. Our sample covers 40 per cent of 2017 leasing revenues (excluding Union Station).

Table 1: Locations Reviewed with Unbilled Additional Rents and Recoveries

Location	*Unbilled rents and recoveries in 2017, by type:*				Estimated 2017 unbilled rents and recoveries	Total estimated unbilled rents and recoveries to date	Additional unbilled recoveries not included in the total estimate of unbilled rents and recoveries to date
	Percentage rents *(refer to Section B.1)*	Utilities *(refer to Section B.2*	Property taxes *(refer to Section B.3)*	Other recoverable operating costs (net of installments) *(refer to Section B.4)*			
1	-	$95,600	-	$52,400	$148,000	$1,871,200	Utility costs prior to 2002 that pre-date records in the City's financial system that likely went unbilled
2	-	-	-	$124,900	$124,900	$788,500**	
3	Not determinable – Calculation incorrect	$80,300	-	-	$80,300	$632,100	Water consumption is currently unmetered
4	-	-	-	$235,100	$235,100	$631,700	
5	Not determinable – Financial statements not available	$27,200	-	-	$27,200	$249,600	Correct percentage rents for 2013 to 2017
6	-	$14,800	-	-	$14,800	$110,700	
7	-	$2,900	-	-	$2,900	$105,600	
8	-	$70,700	-	-	$70,700	$83,800	
9	-	$4,300	-	$19,400	$23,700	$72,500	Facilities maintenance costs that may not have been allocated
*	3 locations	3 locations	6 locations	3-5 locations	Not determinable	Not determinable	
	-	**$295,800**	**-**	**$431,800**	**$727,600**	**$4,545,700**	

Notes:
* Thirteen other locations in our sample had observations related to additional rents and recoveries. The actual amount of unbilled and uncollected additional rents and recoveries is not readily determinable at this time.
** $318,000 in operating costs related to facility work orders that should be reviewed with Legal Services to determine their recoverability under the agreement.

We recognize that 65 per cent of this amount pertains to below market rent tenants. However, as reflected in the agreements we reviewed, it is expected that these below market tenancies be cost-neutral to the City (i.e. tenant pays nominal rent but is responsible for paying their share of building operating costs). The City may decide not to recover operating costs in order to support the program objectives of the community space tenant. Amounts absorbed by the City are similar to a grant provided to the tenant. These grants should be transparently reported to City Council and recorded in the City's financial system as an offset to the building's operating costs.

Likely that additional amounts have gone unbilled

Given the systemic and recurrent nature of our findings, it is likely that additional amounts have gone unbilled over time in the leases we did not review. In this context, it is important that management take prompt action to address the concerns identified. In our view, the City's failure to perform fundamental lease administration activities has resulted in lost revenues to the City.

Issues were previously identified in the 2006 audit

It is concerning that these issues related to very basic lease administration activities. These issues were also previously identified in the 2006 lease administration audit.

Ombudsman issued a report on concerns of how below market rent tenancies were managed

The City's Ombudsman also completed an investigation in 2013 which raised concerns about the timeliness and accuracy of operating cost recoveries from certain below market rent tenants.

The results of the investigation are available at: http://www.ombudsmantoronto.ca/OmbudsmanToronto/media/Documents/Investigative%20Report/Ombudsman-Report-Promises-Made,-Promises-Broken-March-2013.pdf?ext=.pdf

Our findings are described in greater detail in the sub-sections that follow.

Recommendation:

7. City Council request the Director, Real Estate Services, in consultation with other City divisions that administer leases, to perform a complete review of all leases to:

a. identify any accounts where percentage rents were missed and obtain all necessary financial information from occupants to calculate applicable percentage rents

b. identify any accounts where utilities (such as water, gas, and hydro), as well as all operating expense recoveries have been missed

c. recover, where possible, any amounts that have gone unbilled or uncollected from prior periods.

B.1. Percentage Rents Need To Be Billed and Collected

Staff did not always calculate and collect percentage rents

Certain leases include clauses where the City is entitled to a percentage of a tenant's revenue or profit. We observed that in 2016 and 2017, staff retroactively billed for percentage rents owing on a number of leases. These amounts were to catch up on multiple years of unbilled percentage rents.

In addition, in the 13 agreements in our sample with percentage rent clauses, there were:

- Three agreements where staff did not collect the correct amount of percentage rent
- Two agreements where we were unable to verify that the percentage rents collected were correct because relevant financial information from tenants were either not obtained or retained by the City.

Occupants often self-report the financial results upon which percentage rent is based

Where occupants are not required to provide the City with audited financial statements, staff relied on sales and/or income amounts self-reported by the tenant.

Real Estate Services' standard operating procedures suggest, but do not mandate, that agreements include requirements for occupants to provide independently audited financial statements. Audited financial statements should be required where percentage rents are expected to be significant.

Leases are not set up properly in the financial system to automatically notify staff that a percentage rent review is required

Real Estate Services' standard operating procedures require staff to run monthly system-generated reports to identify upcoming percentage rent reviews; however, in practice, these reports are not being generated. In many cases, leases are not set up in the financial system to enable automatic identification that percentage rents should be reviewed and collected.

Recommendation:

8. City Council request the Director, Real Estate Services to establish and implement a process, including appropriate monitoring controls, to:

a. ensure pending percentage rent reviews are efficiently and effectively identified and actioned, leveraging where possible available functionality in the City's financial system

b. ensure percentage rents are calculated based on verifiable financial information and are billed and collected on a timely basis.

B.2. Hydro, Gas, and Water Consumption Need to be Recovered from Tenants

City is entitled to recover utilities from certain occupants

Certain lease agreements contain clauses that require the occupant to pay for utilities such as water, hydro, and gas. In some cases, the occupant is billed directly by utility providers; in other cases, the City arranges for and pays for utilities first, and then recovers these expenses from the occupant.

Over $2.3 million in utilities have not been billed to tenants

As summarized in Table 1, we identified 10 properties in our sample where utility costs were not billed to tenants and recovered. On these properties alone, we estimate that over $296,000 in utility costs have not been billed and recovered in 2017 alone, and that over time, at least $2.3 million in utilities have not been billed to tenants in accordance with their agreements.

Examples where the City did not recover utility costs from tenants

For example, one tenant was not billed for hydro since 2006. The City has paid hydro bills totaling $632,000 which have never been recovered. Management is currently working with Legal Services staff to recover all hydro amounts owing from the occupant.

The tenant has also not been charged for its water consumption since 2006. The need to bill this tenant for water consumption was identified by the Auditor General in early 2017, during the Audit of Water Billing and Collections[11]. In this current audit, the Revenue Services Division confirmed that a separate water meter has still not been installed for this tenant occupying over 23,000 square feet of space.

In another example, since 1989, the City has not billed and collected $106,000 in hydro costs related to a Community Space Tenancy (below market rent lease) that are recoverable in accordance with the lease agreement. We also noted another Community Space Tenancy where the City did not bill the tenant for their water consumption since 2006. The total water charges not billed were approximately $111,000.

[11] https://www.toronto.ca/legdocs/mmis/2017/au/bgrd/backgroundfile-102139.pdf

Furthermore, during our audit we also identified:

- 26 additional properties where hydro costs may not be appropriately allocated and recovered from one or more tenants
- 5 additional properties where water costs may not be appropriately allocated and recovered and 14 other occupied properties without a water meter installed to appropriately bill water consumption.

A list of these sites have been provided to management for further review.

Long-term occupants should directly pay their own utilities

The City should enable long-term occupants to arrange for and directly pay their own utilities, wherever possible. In some cases, this will require the installation of a new meter.

Water consumption generally not recovered from third-party occupants on parkland

Management advised that water is free to parkland. Consequently, as identified in the Auditor General's 2017 audit of water billing and collections, water has not historically been billed to most sites located on City parkland. Where there is a tenant, a meter has to be installed for the leased facility.

Recommendation:

9. City Council request the Director, Real Estate Services, in consultation with other City divisions that administer leases, to establish and implement a process, including appropriate monitoring controls, to ensure all utilities billed to the City that should be recovered from occupants in accordance with their respective agreements are recovered in a timely manner.

B.3. Commercial Occupancies Should be Properly Assessed for Property Taxes

Properties occupied by commercial tenants are taxable

Land owned by the City is exempt from property taxation unless it is occupied by a tenant who would be taxable if the tenant owned the land. This is the case where there are commercial occupancies on City-owned land.

Property taxes have not been assessed, billed, and collected on some properties

As summarized in Table 1, we identified six locations with at least one or more commercial tenants that need to be assessed or re-assessed for property taxes.

Unless they are notified by the City, the Municipal Property Assessment Corporation (MPAC) will not be aware of commercial occupancies that need to be assessed or re-assessed. Management is currently working with MPAC to provide the necessary occupancy information in order to appropriately assess, bill, and collect property taxes. It is likely that there are other commercial occupancies where property taxes have not been appropriately assessed, billed, and collected.

We also identified an additional five occupied properties that may need to be re-assessed for property taxes. Management is aware of these properties and will work with MPAC to ensure they are appropriately assessed.

We did not review exemptions of leased properties from property taxes as part of this audit. However, we did note that property taxes were being recovered from some community space tenancies and not from others.

City needs to determine whether any property tax rebates need to be refunded

On the other side of the spectrum, our audit identified one property where the City received approximately $3.3 million in property tax rebates from 2009 to 2014. In this case, the rebates were received years after tax bills were initially recovered from tenants. Staff are currently compiling historical information (since the commencement of occupancy) to accurately determine whether any amounts are owing back to tenants for property tax rebates that the City received.

Recommendations:

10. City Council request the Director, Real Estate Services, in consultation with other City divisions that administer leases, to establish and implement a process to:

a. review all properties with occupancy agreements to identify any space that needs to be assessed for property tax purposes and notify the Municipal Property Assessment Corporation accordingly

b. ensure that when new occupancies are established on City-owned properties that the Municipal Property Assessment Corporation is notified promptly so that they can be assessed for property taxes.

11. City Council request the Director, Real Estate Services, in consultation with the City Solicitor, to determine the City's contractual right to retain any property tax rebates at commercially-occupied City-owned properties and, if necessary, ensure refunds are distributed to the respective occupants.

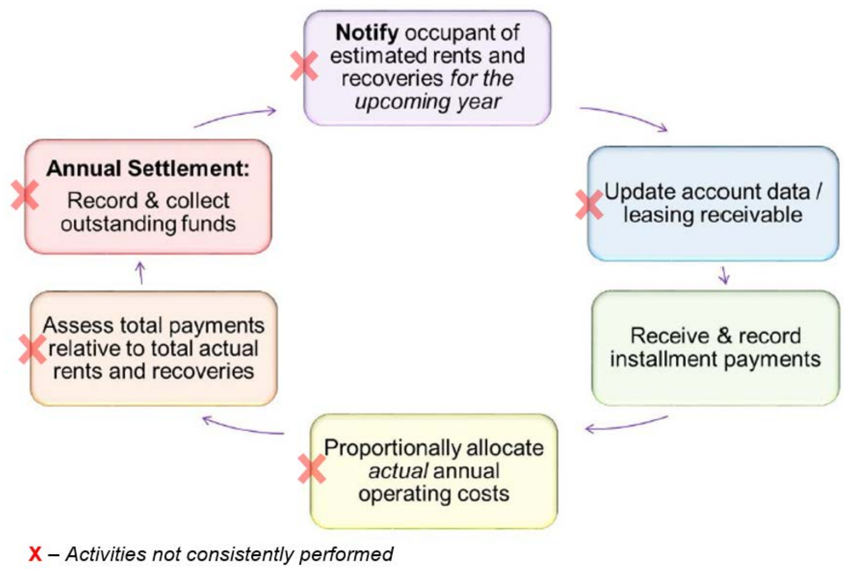
B.4. Recoverable Operating Costs Need to be Accurately Reconciled

City can recover operating costs from occupants

Where agreements require tenants to pay a proportionate share of operating costs, we expected that basic lease administration activities identified in Figure 1, would be consistently performed in a timely manner, on an annual basis.

Expected lease administration activities are not always consistently performed in a timely manner

Figure 1: Expected Annual Lease Administration Activities



Settlements of Rents And Recoveries Need to be Performed

2017 Union Station Leasing Audit identified that settlements of rents and recoveries were not performed

The Auditor General's 2017 report *"Real Estate Services Division – Restore Focus on Union Station Leasing"*, noted that annual estimates and actual settlements of rents and recoveries were not performed. Significant amounts owing went unrecorded, unbilled, and uncollected. At the time, management attributed delays in completing reconciliation and settlements to the complexity of the ongoing revitalization, staff turnover, and the high likelihood of recovery even though settlements had been delayed.

Similarly, in this audit we found that for certain leases:

- the amount of installment payments are not always reviewed annually and adjustments communicated to tenants, as required
- reconciliations of tenants' proportionate share of actual operating expenses and installments are not always accurate and performed on a timely basis
- tenant accounts are not settled annually for any amounts owing to or due from the City.

Settlements in one multi-tenanted building have not been performed since 2012

For example, over 60 tenants in a multi-tenanted building managed by Real Estate Services currently pay rents and installments towards certain operating costs. All the leases expired in 2014. As a result, semi-gross rents which are expected to cover all other operating costs of the facility have not been reviewed since 2008. In addition, annual settlements to reconcile actual hydro usage and settle property taxes have not been performed since 2012. There is no documentation retained to evidence that all tenants have been notified of the City's intent to retroactively reconcile and settle accounts.

Based on data from the City's financial system, after rents and operating expense installments, the City's total net operating loss at the building over the past five years is at least $950,000. This does not include any retroactive reconciliation and settlements that will be applied when the lease extensions are finalized, which would reduce the actual deficit. The City is also currently occupying approximately nine per cent of the rentable area within the building and associated operating costs attributable to this space would not be recovered.

Examples of operating costs not accurately recovered from below market community space tenancies

We also identified a below market rent tenant that was not billed for actual operating costs. Based on information in the City's financial system, we estimate that $148,000 in operating costs were incurred during 2017 alone (and nearly $1.9 million since 2002). These were never billed and recovered in accordance with the tenant's lease agreement.

Risk that the City will be unable to collect where reconciliations are not performed in a timely manner

Accurate and complete reconciliations of actual rents and recoveries relative to installment payments received, and the corresponding settlements of any amounts owing or due, need to be performed in a timely manner. Where amounts due from tenants are not finalized and billed in a timely manner, there is a risk that the City will be unable to collect all applicable rents and recoveries.

Cost Allocation Models Needed for Multi-Tenanted Facilities

Certain common area costs should not be allocated to third party occupants

Similar to leasing issues identified at Union Station, for certain multi-tenanted buildings, formal cost allocation models have not been developed. Models are needed to clearly define how annual operating costs should be proportionally allocated to and recovered from building occupants. These buildings include civic centres and community centres.

For example, at City Hall, in the absence of a defined operating cost allocation model, we found that third-party occupants are treated inconsistently, albeit in accordance with the terms of their agreements. Some third-party occupants are billed and pay for operating costs and property tax recoveries of $29.86 per square foot. One tenant pays a fixed operating cost rate and property tax recoveries of $3.58 per square foot. Some tenants are not required to pay any portion of the building's operating costs.

Rents and Recoveries Need to be Billed and Collected in a Systematic and Consistent Manner

Establish and document methodology for recovering costs from tenants

A documented approach or methodology for performing operating cost reconciliations and proportionate allocation of costs is needed to ensure annual settlement processes are performed efficiently, accurately and completely.

All information needed to perform reconciliations and allocation of costs, as well as the source for the information should be identified, documented and maintained in the appropriate files. This helps to ensure staff can efficiently and effectively carry out their lease administration duties and also supports continuity of knowledge, especially when new staff come on board.

Recommendations:

12. City Council request the Director, Real Estate Services, to review all active leases to ensure reconciliations of recoveries for all periods up to December 31, 2017, are completed and any settlement amounts are recorded in the City's financial system, and appropriately billed and collected from the respective occupants in a timely manner.

13. City Council request the Director, Real Estate Services, in consultation with other City divisions that administer leases, to implement a standardized process that ensures ongoing, timely and accurate billing and collection of estimated and actual recoveries in accordance with all lease agreements.

14. City Council request the Director, Real Estate Services, in consultation with any City divisions managing leases, to:

a. identify all City-owned properties where a cost allocation model is required to allocate the appropriate proportionate share of operating costs to respective occupants

b. develop a cost allocation model that clearly defines how annual operating costs will be allocated to and recovered from the respective occupants including details on the type and source of information for appropriate cost recovery

c. ensure the implemented cost allocation models are used to accurately calculate and allocate operating cost estimates and year-end settlements to the respective occupants.

B.5. Customer Account Balances Need to Be Corrected in the City's Financial Information System

Tenant account balances are inaccurate

The Auditor General's 2017 Union Station leasing audit identified that rent revenue and receivables recorded in the City's financial system was not current or complete. Annual updates to installments, as well as expected amounts owing in respect of operating cost settlements, were not reflected in customer accounts.

In our current audit, we observed that the issues were not isolated to Union Station occupants. We noted the following issues which impact the accuracy of accounts receivable and revenues recorded in the City's financial information system:

- Payments are sometimes cleared against the wrong receivable, impacting the accuracy of aged accounts receivable
- Receivables are not always recorded, resulting in some customer accounts inaccurately reflecting a negative balance when payments were recorded
- Payments do not always match receivables amounts because occupants were not notified of changes to their required operating cost installment payments
- Interest not charged on overdue accounts (Parks, Forestry and Recreation leases).

In two agreements, the occupants made payments that were not first recorded as a receivable in the City's financial system. As a result, when the payments were applied to the customer accounts, the financial system incorrectly shows that the City owes these tenants $588,000.

Recommendation:

15. **City Council request the Director, Real Estate Services, in consultation with the Director, Accounting Services, to establish and implement a process, including monitoring controls, to**

    a. **review the accuracy and completeness of customer accounts in the City's financial system**

    b. **ensure that customer account balances are reviewed annually for accuracy and completeness.**

C. MOVING CITY-WIDE LEASING FORWARD UNDER THE NEW CENTRALIZED SERVICE DELIVERY MODEL

A strategic and coordinated approach to leasing did not historically exist

Historically, a strategic and coordinated approach to leasing City-owned space across all City divisions, agencies, and corporations did not exist. Existing ground leases and building occupancy agreements were negotiated and managed by different divisions including Economic Development and Culture (EDC), Parks, Forestry and Recreation (PF&R), and Real Estate Services (RES).

Development of a leasing strategy is a key activity of the new City-wide real estate service delivery model

In 2016, City Council approved, in principle, the direction to move to a centralized service delivery model for real estate. Developing a City-wide leasing strategy is a key activity of the transformation.

Consolidation of leasing activities within City divisions began in November 2017

In moving forward with the new model, City-wide consolidation of leasing activities within City divisions began in November 2017. Management advised that the PF&R and RES teams have been working together to define the separation of program versus real estate activities in a service level agreement and to transition the real estate activities to RES. Similar discussions also occurred with EDC; RES staff have been supporting real estate activities of that unit since January 1, 2018.

This is the opportune time to affirm Real Estate Services as the central authority going forward to take the necessary actions to:

- set out a coordinated leasing strategy for City-owned property
- define expected outcomes and develop measures to evaluate performance of the complete leasing portfolio
- establish and implement robust City-wide policies and procedures to efficiently and effectively manage leasing activities
- determine the appropriate resourcing strategy to support effective negotiations and ongoing lease administration.

C.1. Identify and Address Vacant Leasable Property Across the City

No process to identify vacant but leasable sites

Management does not currently track space occupancy in all City-owned buildings or have a process in place to identify vacant but leasable sites. For example, we identified approximately 180 addresses that were formerly leased out but may currently be vacant and available for leasing. Management did not have the information readily available to identify the current status of each of these sites.

Errors and incomplete lease information in the City's financial system

In addition, we found errors and incomplete lease data in the City's financial system, which is the primary source for tracking of leases. For example, certain lease information such as the expiry date of leases or the size of leased space are not accurately tracked in the system. For some occupancies, there are no formal executed agreements or there are no extensions or amendments to expired agreements, even though different terms are being applied.

Similar issues were identified in the 2006 audit of lease administration

These findings were previously raised in the 2006 audit of lease administration. The 2006 audit recommended that a centralized inventory of leases for City-owned property be prepared and that all lease information included in this inventory be kept accurate and complete. In addition, the Auditor General recommended that the City implement a process to identify and immediately market vacant properties.

Identifying all leasable space and vacancies is key to developing an effective leasing strategy

A complete and accurate inventory of property and space occupancy is foundational to developing an effective leasing strategy that maximizes value that can be achieved from City-owned properties. Without an accurate and up-to-date lease inventory, City staff do not have access to all the information needed to efficiently and effectively monitor compliance with lease provisions, determine lease expiry dates, and make appropriate leasing and property decisions. Furthermore, if vacant properties are not easily identifiable and leased out on a timely basis, the City is not maximizing value.

For example, as reported in a 2010 staff report to City Council, there is over 5,000 square feet of leasable space in a multi-tenanted, commercial building that could otherwise be leased at market rates to third parties. At that time, it was reported to City Council that the opportunity cost of using the space for City purposes was over $270,000 per year.

Strategy needed to maximize value from parkland space

Historically, leases on City park land have, in large part, been a result of unsolicited third party proposals. The City is allowed to accept unsolicited proposals under certain conditions. The City can apply a “challenge” approach to invite counter quotations or proposals and allow the original proponent to match or improve on the competing counter proposal. This ensures that the best value possible is obtained through a competitive process. Where the City's standard process for unsolicited proposals is not followed, leases, renewals, extensions, and/or amendments arising from such proposals may be granted according to City Council's direction.

A review of all parkland is required to ensure that marketable spaces can be identified and appropriately marketed to interested third parties. Developing a leasing strategy for parks space is necessary to help the City achieve optimal outcomes that balance revenue generation and program objectives.

Recommendation:

16. **City Council request the Director, Real Estate Services, as part of the development of a City-wide leasing strategy and in consultation with relevant program areas, to:**

    a. **establish and maintain an accurate and up-to-date consolidated inventory of leasable space across the City**

    b. **establish a process to identify available vacant leasable space on an ongoing basis and prioritize such space to be marketed to interested parties on a timely basis.**

C.2. Define Expected Outcomes to Measure Performance

No comprehensive assessment of whether expected leasing revenue streams have been achieved

Current internal management reporting and performance metrics do not enable a fulsome evaluation of the performance of the City's lease portfolio. This is necessary information to establishing the right leasing strategy.

In particular, there is no comprehensive assessment of whether expected revenue streams have been achieved. This is particularly important to assess where market rates are lower than base rents together with percentage rents. Furthermore, in many cases because of the way costs are tracked in the City's financial system, it is not possible to efficiently and effectively evaluate the overall financial performance (or profitability) of individual properties.

Defining expected outcomes at the outset, and tracking and analyzing performance over time, is necessary to determine whether leases are performing as expected or underperforming. Measuring performance is crucial for effective decision making that can improve future results.

Recommendation:

17. **City Council request the Director, Real Estate Services, as part of the development of a City-wide leasing strategy, to establish performance measures and track and analyze performance over time to monitor whether the leasing portfolio is performing as expected, and in line with industry benchmarks. Consideration should be given to establishing different measures based on the objectives for different categories of agreements within the portfolio.**

C.3. Address Resourcing of Lease Administration Functions

High staff turnover is a challenge

A significant challenge that Real Estate Services faces in effectively managing leases is a high staff turnover rate in leasing. As a result, Real Estate Services has been administering leases based on demands for immediate action on a lease (such as tenant issues, renewals, account reconciliations, etc.). Management advised that given limited resources, files are prioritized based on program needs, risk, and potential revenue impact.

Some agreements are not assigned to any staff to manage and oversee

Real Estate Services staff are not assigned to manage and review agreements in a systematic manner throughout their entire lifecycle (from agreement negotiations through to expiry). For example, ten out of 25 of the agreements we reviewed were not assigned to any staff to manage on an ongoing basis.

In contrast, Parks, Forestry and Recreation's approach assigns end-to-end responsibility for managing leases (from agreement negotiation to expiry) to specific staff.

Real Estate Services' reorganization in 2018 is expected to put more focus on lease negotiation and administration

As the City develops its leasing strategy, certain core functions and processes that support lease administration need to be addressed. In the first quarter of 2018, Real Estate Services underwent an organizational restructure to align with the City-wide real estate service delivery model. Even so, management is aware that there continues to be resourcing issues that impacts the Division's ability to ensure lease administration functions are done accurately and in a timely manner.

Opportunities to leverage industry and internal practices

Charging tenants an administrative fee can pay for the additional staff needed to effectively administer the leases

It is common commercial practice for landlords to charge an administration fee based on a specified percentage of the operating expenses paid by the landlord and charged back to the tenant. Where Real Estate Services lacks sufficient staff resources to effectively manage and administer leases in a timely manner, the City should consider charging an administrative fee.

$500,000 could be generated annually to cover the cost of lease administration on commercial agreements

Between 2013 and 2017, Real Estate Services billed $3.5 million in average annual operating costs on commercial agreements. A 15 per cent administrative fee could generate over $500,000 annually to fund positions to support a timely and disciplined approach to lease administration activities.

Real Estate Services' standard operating procedures already contains language to include in agreements "an administrative fee not greater than fifteen per cent (15%) of the aggregate of all Operating Costs…" However, few agreements included this requirement.

Administrative fees on commercial construction agreements

We did note some cases where the City has successfully charged administrative fees to recover the cost of staff time and effort related to construction licence agreements. For example, during 2016 and 2017 the City negotiated a total of $30,000 in administrative fees on two construction licence agreements.

Recommendation:

18. City Council request the Director, Real Estate Services to review whether the City should be including an administrative fee in lease agreements to help recover the cost of lease administration. Such review to consider the appropriate fee structure to be applied and any criteria for exempting lessees from such an administrative charge.

C.4. Policies and Procedures Should be Reviewed and Enhanced

Standard operating procedures were developed in response to the Auditor General's 2006 lease administration audit

In response to recommendations in the Auditor General's 2006 lease administration audit, Real Estate Services developed a set of standard operating procedures for staff when performing their lease administration duties. As part of the audit recommendation follow-up process, the Auditor General's Office verifies that recommendations have been implemented. From that point forward, ongoing implementation, maintenance, and improvement in processes rely on management’s continuous efforts beyond the audit follow-up process.

Procedures do not reflect current operations

In reviewing the standard operating procedures and in discussions with staff, it is clear that the guidelines developed in response to the 2006 audit recommendations are in need of an update.

A comprehensive set of clear and specific policies and procedures must be established and implemented

Given the high level of staff turnover in Real Estate Services, and the organizational restructure underway in response to the implementation of the centralized real estate service delivery model, this is the opportune time to develop a comprehensive set of clear and specific policies and procedures. This can standardize expectations for effectively and efficiently administering leases.

Recommendation:

19. City Council City request the Director, Real Estate Services, as part of the development of a City-wide leasing strategy and in consultation with all City divisions that administer lease agreements, to:

a. review and update the existing set of policies and procedures to ensure sufficient specific guidance is provided for staff to effectively carry out lease administration duties

b. establish processes for monitored ongoing compliance with established policies and procedures.

CONCLUSION

This report presents the results of our review of lease administration practices by the City's Real Estate Services and Parks, Forestry and Recreation Divisions.

Addressing the 19 recommendations will remediate lease administration practices in order to ensure that the City maximizes lease revenues and recovers entitled rents and operating costs. Recommendations provide a roadmap for setting the City up to achieve success under the new City-wide approach to real estate service delivery.

It is our view that many of the issues identified in the Auditor General's 2006 audit have persisted over time. Therefore, management's long-term commitment to effectively implementing and enforcing our audit recommendations will ensure these issues do not arise again in the future.

AUDIT OBJECTIVES, SCOPE AND METHODOLOGY

Added to the Work Plan in June 2017

The Auditor General's 2017 Audit Work Plan, updated in June 2017, included a review of City-owned leased properties administered by the Real Estate Services and Parks, Forestry and Recreation Divisions.

This audit was initiated as a result of the findings identified during the 2017 audit *"Real Estate Services Division – Restore Focus on Union Station Leasing"* which is available at:
https://www.toronto.ca/legdocs/mmis/2017/au/bgrd/backgroundfile-105270.pdf

This is the Auditor General's second review of City lease administration

This is the Auditor General's second review of the administration of leases on City-owned properties. The first review was conducted in 2006. The 2006 audit report is available at:
https://www.toronto.ca/legdocs/2006/agendas/committees/au/au060920/it001.pdf

Audit objective to ensure effective lease administration

The objective of this review was to assess the effectiveness of lease administration practices to recover rents and operating costs, and the processes to administer and monitor compliance with occupancy agreements on City-owned properties.

The City's processes for soliciting and evaluating expressions of interest / proposals for properties available for lease were not included within the scope of this audit.

A review of market and below market occupancies

This audit covered the period from January 1, 2016 to December 31, 2017 but also covered occupancy agreements executed prior to this specified period. This review included both commercial and community space tenant occupancies on City-owned properties.

A review of the City's leasing of space from third-parties is not included within the scope of this audit.

Audit methodology

Our audit methodology included the following:

- review of divisional policies and procedures pertaining to lease administration
- interviews with staff from the Real Estate Services, Parks, Forestry and Recreation, and other relevant City divisions
- review of a sample of leases managed on City-owned properties and other related documents and records including:
    - staff reports to City Council
    - records in the City's financial system
    - utility records in the City's energy tracking system
    - reconciliations of rents and operating cost recoveries
- evaluation of management controls
- review of various internal and external reports, including past Auditor General reports on leasing administration
- other procedures as considered appropriate.

Limitations to our audit findings

Our findings and conclusions were based on the information available at the time the audit was completed. In some cases,

- management could not locate the information we requested
- staff turnover limited management's ability to answer our questions
- lease data in the City's financial system was not accurate or up-to-date.

Work on certain matters arising from this audit is ongoing and may be reported upon separately in the future.

Compliance with generally accepted government auditing standards

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

APPENDIX 1: Management's Response to the Auditor General's Report Entitled: "Enhance Focus on Lease Administration of City-owned Properties"

Recommendation 1: City Council request the Director, Real Estate Services, in consultation with all City divisions that negotiate and administer leases, to develop a standard City-wide policy to ensure negotiated rents are consistent with market conditions at the time agreements are executed; and, that appropriate supporting research and financial analysis is retained.

Management Response: ☒ Agree ☐ Disagree

Comments/Action Plan/Time Frame:

As per section 82 of the City of Toronto Act, Real Estate Services' is not permitted to lease or sell any property of the City at below fair market value (aside from City Council's authority to grant exceptions). For every negotiated transaction, Real Estate Services completes an appraisal to ensure the rents are in keeping with market rates. The appropriate supporting research and financial analysis is retained for all new transactions, and as noted in the report there has been a better retention of documents for agreements entered into in the past three years.

The implementation of the city-wide real estate model and the consolidation of authorities under the model since January 1, 2018 will allow for new agreements to be managed consistently, and will create greater consistency across the portfolio.

Policy regarding analysis, due diligence requirements and record retention will be documented by 1Q 2019.

Recommendation 2: City Council request the Director, Real Estate Services, in consultation with all City divisions that administer leases, to develop and implement monitoring controls to ensure all commitments for capital improvements in current and future lease agreements are fulfilled. Such controls to include:

a. specifying in sufficient detail in formal agreements, the nature, expected value, and timing of capital work to be completed

b. logging or tracking all agreements and the related capital commitment

c. obtaining and retaining documentation, such as invoices, to support the value and nature of work completed.

Management Response: ☒ Agree ☐ Disagree

Comments/Action Plan/Time Frame:

Real Estate has developed practices to more effectively perform record keeping to control and track capital improvements for City assets that are leased-out. Such practices will be put into effect immediately and will be covered for all new agreements.

A review of current agreements that include commitments for capital will be undertaken by 1Q 2019.

Recommendation 3: City Council request the Director, Real Estate Services, in consultation with all City divisions that negotiate and administer leases, to:

a. establish standard City-wide lease terms that include rent escalations and/or periodic market rent reviews in longer-term lease agreements; and, where the terms are not applied, ensure justification for the exception is documented and reviewed by management

b. implement monitoring controls to ensure required rent increases or periodic market reviews are completed in a timely manner.

Management Response: ☒ Agree ☐ Disagree

Comments/Action Plan/Time Frame:

Real Estate Services' general practice has been with new leases to include general rent escalations for any contract that is over 5 years unless counter party provides alternatives in negotiations. Real Estate Services will advise legal to have a rental escalation clause as a standard, and when the terms are not applied will ensure justification for the exception is documented and reviewed by management.

With respect to Recommendation 3b, in May 2017 Real Estate Services initiated an internal lease administration review performed by the Business Management Unit of the Deputy City Manager's (Internal Services) Office. In Q1 2018, Real Estate Services underwent an organizational restructure with alignment around key functions including lease transactions and administration. In Q2, 2018, the formation of a dedicated team was established to drive implementation of the improvement opportunities identified throughout the lease administration review. One of the key improvement opportunities was the lease reconciliation process, which encompasses item 3b by examining on an annual basis what contracts require rent escalations. The strategy and process for reconciling accounts will be finalized by Q4 2018, as well as the work-plan for the annual reconciliation of accounts. The work-plan will be driven by value and risk and will be phased and implemented through 2019.

Recommendation 4: City Council request the Director, Real Estate Services, in consultation with the City Solicitor, to review all leases currently in overhold to determine whether the City can and should retroactively bill and collect all rents owing in accordance with the overhold rate specified in the respective agreement.

Management Response: ☒ Agree ☐ Disagree

Comments/Action Plan/Time Frame:

RES is in the process of reviewing all overholding leases & licences and prioritizing the files that need to be renegotiated by value and risk. Agreements that have overholding provisions will be reviewed by staff & City legal to see if there is a legitimate opportunity to collect retroactive overholding rent. To be completed by Q2 2019.

Recommendation 5 City Council request the Director, Real Estate Services, in consultation with the City Solicitor, to establish criteria for determining when a month-to-month overhold rate should be included in new, extended, or amended lease agreements.

Management Response: ☒ Agree ☐ Disagree

Comments/Action Plan/Time Frame:

As of 2016 the new standard form of lease for at market leases contains an overholding provision. Extended and amended agreements will be addressed on a case-by-case basis dependent on the specific lease provisions.

Recommendation 6: City Council request the Director, Real Estate Services to establish a process to ensure the lease management system is accurately set up to automatically alert staff to:

a. agreements where negotiations for the next term should commence in order to prevent unnecessary overholding

b. charge the appropriate overhold rate upon agreement expiry, where appropriate; and take action to address expired agreements in a timely manner.

Management Response: ☒ Agree ☐ Disagree

Comments/Action Plan/Time Frame:

As part of the lease administration process, staff are notified of contract end dates on a monthly basis. In Q3, 2018, staff will also be notified of contract end dates up to 6 months in advance. Working with existing resources, staff will prioritize account transactions by value and risk.

Overholding rates will be applied when appropriate; i.e. negotiations commenced within an acceptable timeframe and protracted negotiations between the City and Tenant.

Recommendation 7: City Council request the Director, Real Estate Services, in consultation with other City divisions that administer leases, to perform a complete review of all leases to:

a. identify any accounts where percentage rents were missed and obtain all necessary financial information from occupants to calculate applicable percentage rents

b. identify any accounts where utilities (such as water, gas, and hydro), as well as all operating expense recoveries have been missed

c. recover, where possible, any amounts that have gone unbilled or uncollected from prior periods.

Management Response: ☒ Agree ☐ Disagree

Comments/Action Plan/Time Frame:

As stated above in the Management Response to Recommendation 3b, one of the key improvement opportunities was the lease reconciliation process, which will assist in implementing this recommendation. The strategy and process for reconciling accounts will be finalized by Q4 2018, as well as the work-plan for the annual reconciliation of accounts, which will identify those leases and licences were percentage rents and / or operating costs need to be collected. The work-plan will be driven by value and risk and will be phased and implemented through 2019.

Recommendation 8: City Council request the Director, Real Estate Services to establish and implement a process, including appropriate monitoring controls, to:

a. ensure pending percentage rent reviews are efficiently and effectively identified and actioned, leveraging where possible available functionality in the City's financial system

b. ensure percentage rents are calculated based on verifiable financial information and are billed and collected on a timely basis.

Management Response: ☒ Agree ☐ Disagree

Comments/Action Plan/Time Frame:

As stated above in the Management Response to Recommendation 3b, one of the key improvement opportunities of the lease administration review was the lease reconciliation process, which will assist in the implementation of this recommendation. The strategy and process for reconciling accounts, including accounting for and verifying percentage rents, will be finalized by Q4 2018, as well as the work-plan for the annual reconciliation of accounts for implementation. The work-plan will be driven by value and risk and will be phased and implemented through 2019.

Recommendation 9: City Council request the Director, Real Estate Services, in consultation with other City divisions that administer leases, to establish and implement a process, including appropriate monitoring controls, to ensure all utilities billed to the City that should be recovered from occupants in accordance with their respective agreements are recovered in a timely manner.

Management Response: ☒ Agree ☐ Disagree

Comments/Action Plan/Time Frame:

As stated above in the Management Response to Recommendation 3b, one of the key improvement opportunities of the lease administration review was the lease reconciliation process, which will assist in implementation of this recommendation. The strategy and process for reconciling accounts will be finalized by Q4 2018, which will include ensuring the proper operating costs (including utilities) are monitored and recovered and where appropriate, consideration will be given to enabling occupants to arrange for and directly pay their own utilities. The work-plan for the annual reconciliation of accounts will assist in implementation. The work-plan will be driven by value and risk and will be phased and implemented through 2019.

Recommendation 10: City Council request the Director, Real Estate Services, in consultation with other City divisions that administer leases, to establish and implement a process to:

a. review all properties with occupancy agreements to identify any space that needs to be assessed for property tax purposes and notify the Municipal Property Assessment Corporation accordingly

b. ensure that when new occupancies are established on City-owned properties that the Municipal Property Assessment Corporation is notified promptly so that they can be assessed for property taxes.

Management Response: ☒ Agree ☐ Disagree

Comments/Action Plan/Time Frame:

The lease administration review as included in 3b identified the process opportunity surrounding the assessment of agreements/occupancies for treatment of property taxes. Working in collaboration with City Legal and Revenue Services, the new process will documented and implemented by Q4 2018.

To address 10a, a review of all properties with current occupancy agreements will be undertaken and a work-plan developed to address any cases where MPAC needs to be engaged by 1Q 2019.

For new occupancies and to address recommendation 10b, Real Estate Services in consultation with City Legal and Revenue Services, has been reviewing for treatment of property taxes.

Recommendation 11 City Council request the Director, Real Estate Services, in consultation with the City Solicitor, to determine the City's contractual right to retain any property tax rebates at commercially-occupied City-owned properties and, if necessary, ensure refunds are distributed to the respective occupants.

Management Response: ☒ Agree ☐ Disagree

Comments/Action Plan/Time Frame:

By Q4 2018, Real Estate Services will conduct an examination and update of the current process by which property tax rebates are treated, including a review of properties that have received rebates. In conjunction with Legal Services, Real Estate Services will obtain a determination as to the legal requirements for when a credit is due to respective occupants.

Recommendation 12: City Council request the Director, Real Estate Services, to review all active leases to ensure reconciliations of recoveries for all periods up to December 31, 2017, are completed and any settlement amounts are recorded in the City's financial system, and appropriately billed and collected from the respective occupants in a timely manner.

Management Response: ☒ Agree ☐ Disagree

Comments/Action Plan/Time Frame:

As stated above in the Management Response to Recommendation 3b, one of the key improvement opportunities of the lease administration review was the lease reconciliation process, which encompasses Recommendation 12. The strategy and process for reconciling accounts will be finalized by Q4 2018, as well as the work-plan for the annual reconciliation of accounts. This will include recording any expected settlements as well billings and collections. The work-plan will be driven by value and risk and will be phased and implemented through 2019.

Recommendation 13: City Council request the Director, Real Estate Services, in consultation with other City divisions that administer leases, to implement a standardized process that ensures ongoing, timely and accurate billing and collection of estimated and actual recoveries in accordance with all lease agreements.

Management Response: ☒ Agree ☐ Disagree

Comments/Action Plan/Time Frame:

As stated above in the Management Response to Recommendation 3b, one of the key improvement opportunities of the lease administration review was the lease reconciliation process, which will ensure this recommendation is implemented. The process for reconciling accounts will be finalized by Q4 2018, as well as the work-plan for the annual reconciliation of accounts. The work-plan will be driven by value and risk and will be phased and implemented through 2019.

Recommendation 14: City Council request the Director, Real Estate Services, in consultation with any City divisions managing leases and licences, to:

a. identify all City-owned properties where a cost allocation model is required to allocate the appropriate proportionate share of operating costs to respective occupants

b. develop a cost allocation model that clearly defines how annual operating costs will be allocated to and recovered from the respective occupants including details on the type and source of information for appropriate cost recovery

c. ensure the implemented cost allocation models are used to accurately calculate and allocate operating cost estimates and year-end settlements to the respective occupants.

Management Response: ☒ Agree ☐ Disagree

Comments/Action Plan/Time Frame:

A review of agreements and properties will be undertaken to prioritize based on value and / or risk and a work-plan will be developed and implemented through 2019.

Recommendation 15: City Council request the Director, Real Estate Services, in consultation with the Director, Accounting Services, to establish and implement a process, including monitoring controls, to

a. review the accuracy and completeness of customer accounts in the City's financial system

b. ensure that customer account balances are reviewed annually for accuracy and completeness.

Management Response: ☒ Agree ☐ Disagree

Comments/Action Plan/Time Frame:

As stated above in the Management Response to Recommendation 3b, one of the key improvement opportunities of the lease administration review was the lease reconciliation process, which will include the management of customer accounts and accounts receivables. The process to address this will be finalized by Q4 2018, with implementation to be driven by value and risk and will be phased and implemented through 2019.

Recommendation 16: City Council request the Director, Real Estate Services, as part of the development of a City-wide leasing strategy and in consultation with relevant program areas, to:

a. establish and maintain an accurate and up-to-date consolidated inventory of leasable space across the City

b. establish a process to identify available vacant leasable space on an ongoing basis and prioritize such space to be marketed to interested parties on a timely basis.

Management Response: ☒ Agree ☐ Disagree

Comments/Action Plan/Time Frame:

Through the City-wide real estate review in 2017 staff had identified a need for the creation of a City-wide strategy related to use of space, including leasing.

As part of the implementation of the city-wide real estate model, a leasing strategy is to be developed and will be addressing recommendations 16a and b. Initially, CreateTO, in consultation with Real Estate services and other City divisions, will develop a portfolio strategy expected by 1Q 2019, which will be build off of to inform and support a City-wide leasing strategy. This will include management of leasable space, and how vacant space is utilized across the City.

Recommendation 17: City Council request the Director, Real Estate Services, as part of the development of a City-wide leasing strategy, to establish performance measures and track and analyze performance over time to monitor whether the leasing portfolio is performing as expected, and in line with industry benchmarks. Consideration should be given to establishing different measures based on the objectives for different categories of agreements within the portfolio.

Management Response: ☒ Agree ☐ Disagree

Comments/Action Plan/Time Frame:

Through the City-wide real estate review in 2017 it was noted that competing priorities across Divisions resulted in isolated decisions with respect to Real Estate, which would not always result in the greatest value for the City. The consolidation of authorities, and the development of a leasing strategy, will allow for common objectives and performance measures to be utilized to assess the value or performance of the portfolio.
RES will build off the leasing strategy to be developed and its current performance measures, to establish new measures that will be used to measure performance and results of the strategy's implementation.

Recommendation 18: City Council request the Director, Real Estate Services to review whether the City should be including an administrative fee in lease agreements to help recover the cost of lease administration. Such review to consider the appropriate fee structure to be applied and any criteria for exempting lessees from such an administrative charge.

Management Response: ☒ Agree ☐ Disagree

Comments/Action Plan/Time Frame:

Real Estate Services will conduct a review regarding whether the City should be including an administrative fee in lease and licence agreements to help recover the cost of lease administration, including the appropriate fee structure and appropriate exemptions. Review with recommendations to be completed by Q1, 2019.

Recommendation 19: City Council City request the Director, Real Estate Services, as part of the development of a City-wide leasing strategy and in consultation with all City divisions that administer lease agreements, to:

a. review and update the existing set of policies and procedures to ensure sufficient specific guidance is provided for staff to effectively carry out lease administration duties

b. establish processes for monitored ongoing compliance with established policies and procedures.

Management Response: ☒ Agree ☐ Disagree

Comments/Action Plan/Time Frame:

As part of Real Estate Services' Q1 2018 organizational restructure, the Property Management and Lease Administration unit was established to focus on effectively administrating leases. A review of existing policies and the development of a new policy and procedures guideline for said unit has been underway since the restructure, and will be finalized by Q4 2018. Working with existing resources, processes for ongoing compliance with policies and procedures will be included in the guideline.
