

## AUDIT AT A GLANCE

### WHY THIS AUDIT MATTERS

Effective lease administration is essential for ensuring the City is meeting program and strategic objectives, generating optimal rent revenues, and recovering operating costs from tenants.

As the City moves forward with the City-wide Real Estate Transformation, leasing activities across the City will be consolidated. Management recognizes and is prioritizing the need to improve lease administration processes. There is new leadership of the portfolio and this audit will provide a roadmap to support leadership going forward.

### BACKGROUND

This audit was initiated as a result of the findings from the Auditor General's 2017 report, "Real Estate Services Division: Restore Focus on Union Station Leasing". That audit identified that the City was not billing or collecting certain rents and operating costs from tenants at Union Station.

### BY THE NUMBERS

- \$53M in leasing revenues (rents and recoveries) in 2017
- 1,070 leases for the use of City owned properties are managed by Real Estate Services or Parks, Forestry and Recreation
- 350 leases are expired yet occupancy continues

*In our audit sample covering 40% of 2017 leasing revenues (excluding Union Station):*

- 46% of commercial leases did not have documents retained to support negotiated rents
- \$14.1M in capital improvements where there is insufficient evidence of the value received
- \$0.9M could have been generated if expired agreements were promptly renewed
- \$4.5M additional rents and recoveries for prior periods not billed to tenants (\$728,000 in 2017)
- \$0.5M could be generated annually by charging a fee to recover the cost of lease administration

### Enhance Focus on Lease Administration of City-Owned Properties

This audit highlights the need to focus on effective lease administration and to ensure the City receives all entitled revenue from leasing out City-owned properties. The City needs to effectively review and monitor leases in order to bill and collect the right amount of rents and recoveries. A review of all leases is required to address our audit findings.

#### What we found

#### A. Effective Review and Monitoring Needed to Maximize Lease Revenues

- Rents may not be based on market rates – documents to support the basis for negotiated rents were not retained in 11 of 24 commercial leases (46%). We noted better record retention in support of more recent agreements.
- City is not ensuring tenants fulfill their obligations for contracted capital improvements – there was insufficient evidence to support the receipt of \$14.1 million in required capital improvements.
- Incremental rent revenues are lost when rent escalations, rent reviews, and lease renewals are not performed – an additional \$931,000 could have been generated if expired agreements were promptly renewed with rents annually adjusted in line with inflation (using the Consumer Price Index).

#### B. Action Needed to Bill and Collect Additional Rents and Recoveries

- In addition to basic rent, commercial leases may require percentage rents, utility costs, property taxes, and/or other eligible operating expenses to be calculated and recovered. In nearly half the leases we reviewed (22 out of 45), the City did not calculate, bill, or collect additional rents and recoveries.
- In our sample, we identified at least \$4.5 million that have not been billed for prior periods, of which at least \$728,000 relates to 2017. 65% 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.
- It is likely that additional concerns exist and amounts have gone unbilled over time in the leases we did not review.

#### C. New Service Delivery Model Centralizes Lease Administration

This is the opportune time to establish a coordinated strategy to maximize value from City-owned property, develop effective performance measures, standardize City-wide policies and procedures, and ensure appropriate resourcing of the leasing function. A 15% fee applied to operating cost recoveries for commercial agreements could generate over \$500,000 annually to help recover the cost of lease administration.

#### How Recommendations will Benefit the City

The audit makes 19 recommendations to help ensure that the City meets its program and strategic objectives, maximizes rent revenues, and recovers operating costs. Implementing the recommendations will improve how the City manages its leasing agreements going forward as well as how the City collects its rental income.